

# **SCHOOL DISTRICT FINANCIAL MANAGEMENT: PERSONNEL, POLICIES, AND PRACTICES**

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## **SCHOOL DISTRICT FINANCIAL MANAGEMENT: PERSONNEL, POLICIES, AND PRACTICES**

### **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.

## Introduction

Public school districts in California are responsible for providing a free education to more than 6 million kindergarten to 12th-grade students. The news media and the public at large pay careful attention to how the public school system is performing its primary task of educating students. Studies that rank California students' performance on national tests and the state's announcements regarding test scores and school performance receive broad coverage.

The performance of the school district as a business enterprise, however, seldom garners much attention except when there is a crisis. Districts forced to seek emergency financial assistance from the state will draw the attention of the press and policymakers. A teachers' strike will focus the community's interest, as will a proposal to close a local school.

The focus of this study is the financial management of California school districts and its relationship to strong fiscal health. How significant are external factors in determining the fiscal health of school districts? What do the state, school districts, and county offices of education do now to promote fiscally healthy districts and prevent state emergency loans and takeovers? How effective are those actions? What matters most—district leadership, financial systems, personnel qualifications, staffing levels, collective bargaining, or private contributions? And to what extent do school district financial management practices in California consider the strategic use of public education resources to make schools more effective and efficient at the task of educating students?

In California, just maintaining a solid financial operation can be challenging for a variety of reasons, including the complexity of the school funding system and the general lack of control school districts have over their revenues since the passage of Proposition 13 in 1978.

California's nearly 1,000 school districts vary in their ability to maintain strong fiscal health within this environment. They also differ in the qualifications and stability of the personnel responsible for their financial management, the nature of their governance and leadership, and their financial management practices.

This study examines the extent to which California school districts vary in some of these areas. It also looks at the relationship of selected aspects of financial management to districts' fiscal health and at the extent to which conditions outside of a district's control—from state budget decisions to declining enrollment—correlate with fiscal health. This work fits into a larger portfolio of studies examining a wide range of issues related to school funding adequacy, efficiency, and effectiveness in California.

A major question for this study is what relationships exist between the fiscal health of California school districts, the conditions under which they operate, and their personnel, practices, and policies related to financial management. To answer this question, the study:

- describes the fiscal health of school districts in California within the larger context of policy and economics in the state from 2002–03 to 2004–05. In the process of doing so, we use a new approach for measuring school district fiscal health.

- examines the relationship between that fiscal health measure and conditions over which districts have limited control, including student enrollment and district revenues.
- describes a variety of school district personnel qualifications, policies, and practices that could have an effect on fiscal health, including: the stability and qualifications of top district personnel; practices related to board governance and financial decision-making; district budgeting, accounting, and finance practices; compensation practices, such as collective bargaining and retiree health benefits; resource allocation and financial management at school sites; and district success at maximizing revenues.
- examines the relationship between these personnel characteristics and practices and districts' fiscal health.

This study also summarizes the perspectives of chief business officers in selected school districts on the financial challenges they have seen and expect to see in their districts. It also reports on their strategies for dealing with anticipated enrollment changes.

### ***About the authors***

This study is a collaborative undertaking by EdSource and School Services of California, under the direction of Professor Susanna Loeb of Stanford University. Joel Montero, chief executive officer of the Fiscal Crisis and Management Assistance Team (FCMAT), also provided invaluable advice and feedback.

The approach used for this study reflects the background and experience of the authoring organizations. Along with research conducted specifically for this study, we have drawn from our organizations' extensive expertise supporting the education community in California. For 30 years, School Services of California has served as a highly respected and trusted fiscal advisor to the education community, particularly school district leaders. The firm also lobbies on behalf of districts. During the same time, EdSource has built a reputation for providing accurate, impartial analysis and communications regarding complex education policy issues in the state, with a particular emphasis on school finance.

We approached this work with an objective research lens, but the study's development and findings are strongly informed by our direct knowledge and experience of the education field. A central part of our data collection involved a survey of chief business officers throughout California. The survey questions in particular reflected our collective understanding of both the theoretical and practical aspects of school business management as well as the particular context within which both exist in California.

## **Background**

The first and perhaps dominant reality regarding California's public school system is its vast size and diversity. The system's formal network includes:

- more than 9,000 public schools;
- almost 1,000 public school districts that range in size from 20 or fewer students to more than 700,000;
- close to 600 charter schools within the public system; and



- 58 county offices of education (COEs).

At the state level, a number of different individuals and agencies influence public education priorities and resource commitments. Education leadership is spread among the following:

- the California Department of Education (CDE), led by an elected superintendent of public instruction;
- the state Legislature and governor, who together decide on the state's budget and establish policies for how education funds can be spent;
- the secretary for education, an appointed policy advisor to the governor; and
- the State Board of Education (SBE), whose members are appointed by the governor and confirmed by the Legislature.

## **Conditions under which school districts operate in California**

School districts are the fiscal agents responsible for the management of the schools under their purview. The variation in their size and configuration leads to differences in the challenges school district leaders face in managing them financially. That said, all districts in California operate within the larger context of a state-controlled school finance system.

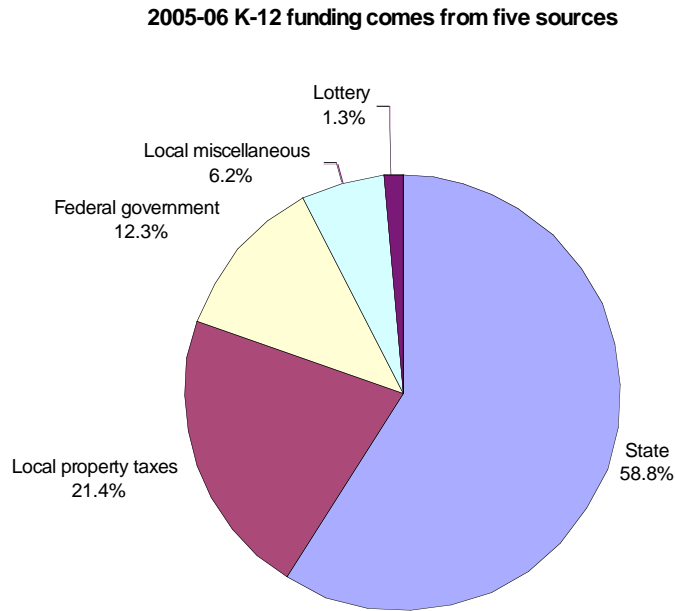
### ***A revenue system controlled by the state***

California's public education system is supported primarily by state sales and income tax revenues and by local property taxes. These are supplemented with money from the federal government, the California Lottery, and miscellaneous local funds that districts generate.

As the chart below indicates, the state controls about 82% of the funding for public education. State funding levels are driven by the interaction of the property tax and state General Fund taxes (largely sales and income taxes). Since 1988, a minimum-funding guarantee for public education has guided state funding. Created by Proposition 98, a voter-approved initiative, these provisions (among other requirements) specify a minimum portion of every General Fund dollar that is to be allocated to education. The lottery provides a small portion of education funding, about 1.3% in 2005–06.

**Figure A: Annual funding proportions**

The estimated proportions for 2005–06 are typical of how operating funds for schools are generated, though changes occur from year to year.



**State aid:** comes mostly from California sales and income taxes.

**Property taxes:** collected locally but allocated to schools based on a state-determined formula.

**Federal aid:** is earmarked for special purposes, most notably Child Nutrition, Special Education, and No Child Left Behind (NCLB).

**Local miscellaneous:** includes such sources as community contributions, interest income, developer fees, and revenues from local parcel tax elections.

**Lottery:** a portion of the proceeds from the California Lottery goes to school districts on a per-pupil basis, providing a modest per-pupil allocation to every district and to charter schools.

Dollars generated by the Proposition 98 guarantee are distributed to school districts, county offices of education, charter schools, and other entities authorized by the state to provide education programs and receive funds.<sup>1</sup> On rare occasions, some funds may go directly to individual schools. The bulk of federal funds are distributed through the CDE to districts and then to schools, often based on set formulas with many restrictions on how the funds can be used.

<sup>1</sup> Community colleges receive about 10%.

### Districts develop budgets simultaneously with the state budget process

In California, both the state and school districts operate on a fiscal-year calendar that begins on July 1. While state leaders often miss their constitutional deadline for adopting a budget, school districts do not have that latitude. Thus districts typically develop their official budgets based on estimates of how much funding they will receive from the state, but prior to the Legislature and governor’s official budget adoption.

While the state budget adoption generally makes clear the level of funding available for K–12 education, districts still cannot be sure of the total revenues they will receive or what rules they must follow to qualify for funding. State leaders can continue to develop policies for resource allocation until early fall—well after school begins. The process of estimating state and federal revenues requires district leaders to combine informed estimates from past experience and expert guidance on the political landscape as they do their financial planning.

### Some allocations come with spending requirements

State funding is divided into general purpose and categorical sources. General purpose funding provides the bulk of the revenue school districts use to support their operations and deliver services to students. Local school boards have the greatest discretion over the expenditure of these funds.

Categorical funds are provided for specific supplemental or state-directed purposes and must be spent in accordance with the particular laws and regulations for each individual program. Special education, class size reduction, and student transportation are common examples of categorical programs. Discretion over the policies surrounding expenditure of categorical funds rests largely with the state of California, not the local school board. All federal funding also falls into this category.

Most of each district’s general purpose revenue comes from the Base Revenue Limit (BRL) that specifies how much a district is entitled to receive for each student in attendance. The BRL per student is similar, but not exactly the same, for each district. The variations can be traced to differences in expenditure levels at the time revenue limits were established by Senate Bill (SB) 90 in 1972. Additionally, BRL funding is stratified by type of district, with high school districts receiving the highest amount per student, elementary districts the least, and unified districts (those serving all K–12 grade levels) receiving a rate in between. Small school districts also generally receive higher amounts per pupil. Long-term state efforts to equalize these amounts have kept the variations within these groups of districts relatively limited, but there are some extreme outliers, particularly at the high end.

The BRL is funded through a combination of property taxes and state aid. It is a zero-sum game. If property taxes per average daily attendance (ADA) is lower than the BRL, the state makes up the difference. If property taxes go down, the state’s share goes up and vice versa. In a few cases, property taxes per ADA exceed the BRL. Those districts, called “basic aid” districts, are discussed below.

### The bulk of funding is distributed to districts based on the number of students

In most instances, the state distributes both general purpose and categorical funds by simply multiplying the number of students in a district qualified and entitled to receive services from a particular funding source by a specified amount per student. Some categorical funding is distributed on the basis of grant applications as well.

For funding purposes, a “student” is most often defined as one unit of average daily attendance (ADA). A full unit of ADA is earned for each student who attends each and every day of the school year. All absences—excused or unexcused—reduce a district’s funded units of ADA, resulting in fewer dollars. The average unified district earns funding for approximately 96% of its enrolled students.

For most California school districts then, the number of students is a driving force in financial planning. Further, while district costs such as staffing and materials are driven by the number of students enrolled, revenues are largely driven by the yearly average of students who attend. Accurate budgeting and sound financial management thus depend in an important way on the ability of district leadership to estimate not only how many students will sign up for school, but also what the average attendance will be.

### Districts control some limited revenue sources

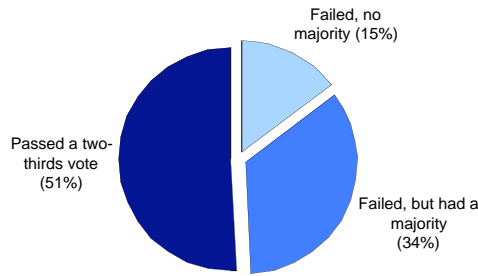
In addition to the major sources of funding listed above, school agencies can generate supplemental funding from a variety of sources. These represent the bulk of Local Miscellaneous Funds (see Figure A). Districts vary widely in the extent to which they pursue and secure these sources of funding.

Foundations, businesses, booster clubs, and other entities often provide financial support to particular schools or school districts, sometimes for a specified purpose and sometimes with no strings attached. For some districts, in-kind contributions of equipment, materials, or volunteer hours represent a substantial supplement to public funding sources.

The law also allows school districts to assess parcel taxes on local residents if they can secure a two-thirds approval from voters. Parcel taxes are a non ad valorem tax, a flat fee on each parcel rather than on the assessed value of property. The ballot proposal prepared by the school district governing board describes how the money will be used. Parcel taxes are usually established for a limited number of years as well.

From 1983 through June 2006, voters approved 209 parcel taxes in 412 elections; 142 received a majority vote but not the necessary two-thirds approval.

Figure B: Parcel tax elections  
(1983 through June 2006)



In all, only 210 school districts out of nearly 1,000 have attempted to pass a parcel tax, and some districts have passed multiple levies. As Table 1 below shows, a disproportionate number of these elections have been in the San Francisco Bay Area. In addition, about 90% of the elections were held in districts that were below the state average of 49% low-income students. A commonly-accepted explanation is that wealthier communities are either better able or more willing to tax themselves to improve their schools. Just five districts that have passed parcel taxes since 2000—all in the Bay Area—serve a higher-than-average proportion of low-income students. They include Ravenswood City Elementary in San Mateo County, Alum Rock Elementary in Santa Clara County, West Contra Costa Unified in Contra Costa County, and Emery Unified and Oakland Unified in Alameda County.

**Table 1: California counties with the greatest number of parcel tax elections between January 2000 and June 2006\***

County	No. of School Districts	% of Districts that Held Elections	Total Elections Passed Out of Those Attempted*
Santa Clara	32	56%	13 out of <b>28</b>
San Mateo	23	57%	13 out of <b>22</b>
Sonoma	40	38%	8 out of <b>19</b>
Alameda	21	43%	13 out of <b>15</b>
Marin	20	55%	12 out of <b>15</b>
Contra Costa	18	39%	8 out of <b>13</b>
Los Angeles	84	12%	5 out of <b>12</b>

\* 161 parcel tax elections were attempted between January 2000 and June 2006.

Capital funds are separate from operating funds

The annual funding under Proposition 98 is strictly for school district operations, including relatively minor purchases of supplies and equipment. There is no designation within Proposition 98 for funding for capital improvements. Although the use of districts’

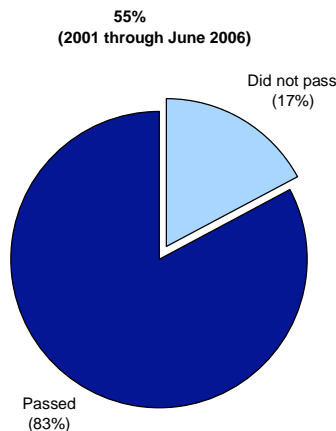
operating funds for this purpose is not prohibited—and sometimes occurs—there is no expectation on the state’s part that district operating budgets will fund large capital improvements. The state does expect districts to use some of their operating funds for building maintenance, however.

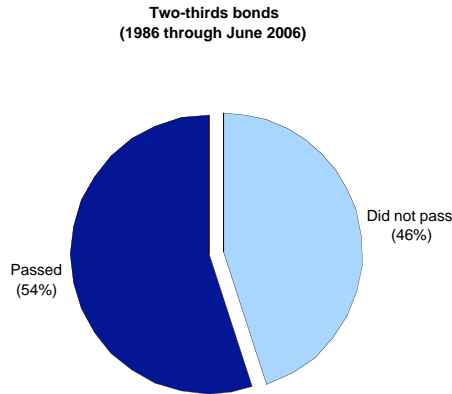
For their capital budgets, school districts depend primarily on funds provided by state and local school facilities bonds. These bonds require voter approval. Statewide bonds can pass with a 50% majority vote. Local bonds require a “super-majority” of either 55% or 66.67% of local voters in a school district.

From 1998 to 2005, the total amount raised through state bonds was \$24.3 billion. Distribution of the proceeds from these bonds is handled by the Office of Public School Construction (OPSC) as the administrative arm of the State Allocation Board. In most cases, local districts are required to match state bond funds. They generally do so using sources such as local developer fees, or more often through passage of a local bond.

Since 1986 school districts have been able to seek approval for local general obligation bonds for school construction or renovation, to be repaid through property taxes. Until November 2000, a two-thirds vote was required for passage. At that time California voters approved Proposition 39, giving districts two options for passing a bond. They can hold a two-thirds election at whatever time they choose and with few oversight requirements. Or they can pursue a 55% approval if they put the bond measure on a regularly scheduled ballot, limit the size of the bond, and agree to abide by several administrative requirements. Of the 929 elections under the two-thirds requirement from 1986 through June 2006, 54% succeeded. Of the 338 elections using the 55% option from 2001 to June 2006, 83% succeeded.

**Figure C: Local bond elections**





### School district flexibility is limited

In summary, California’s schools have very little discretion or flexibility in the level of revenues they receive. Maximizing attendance and claiming funding for programs for which the district or school is eligible are important. Enhancing local funding through foundations, parcel taxes, and other sources is also helpful. But in the end, the vast majority of a district’s revenues are generated by numbers of students multiplied by their eligibility for a particular source of funding.

### ***Special circumstances: “basic aid” districts, “direct service” districts***

A few of California’s nearly 1,000 school districts stand out as exceptions in terms of either how they get their revenues or how they are managed.

### “Basic aid” districts have property taxes that exceed their revenue limit

As noted above, California’s school districts generally depend on a combination of property taxes and state aid for their general purpose funding, most of which is provided through the Base Revenue Limit. However, about 50 districts regularly generate property tax revenues that exceed their BRL amount. These districts are termed “basic aid” districts. They are allowed to keep all the property taxes they collect but receive no other general purpose funding from the state. Like all districts, basic aid districts receive some categorical funding, the amount of which depends on the students they serve and the programs for which they qualify.

The budgeting process for basic aid districts is fundamentally different. Their general purpose revenues are typically more predictable from year to year because they do not depend on student count and property taxes are a relatively stable revenue source. And while other districts have an incentive to maximize their ADA in order to receive additional funds, basic aid districts can benefit from a lower student count that leaves them with more funds per student. A small segment of districts find themselves on the borderline, with the ratio of revenues to students pushing them back and forth from regular to basic aid status even within

a single year. This certainly adds complexity to their financial management practices and budgeting strategies.

### Some “direct service” districts delegate their fiscal responsibilities

Another exception to standard processes is “direct service” districts. Of the state’s 979 school districts, 396 qualify to be direct service districts based on size. These districts, by law, must have fewer than 901 elementary students, 301 high school students, or 1,501 unified students (Education Code 2550). They can depend on their local county office of education for a variety of services, such as instructional supervision, attendance supervision, health services for pupils, and guidance services. For some of the smallest districts, this includes financial management and the COE officially acts as the district’s chief business officer.

In 2004–05, there were 326 elementary school districts, 68 unified districts, and two high school districts eligible for direct service status. Data regarding the number that receive financial services or turn over their fiscal duties to their COE completely are not readily available.

### ***The state has several policies and controls related to fiscal health***

The state of California has established standards for financial management and created a system of fiscal accountability and oversight for school districts. The standards are broad in scope, dealing with such things as required reporting, data formats, a standard account code structure, and purchasing and bidding procedures. These are in addition to regulations on the operation and funding of each individual restricted program.

Of California’s 58 county offices of education, 51 provide secondary fiscal oversight for the state’s school districts.<sup>2</sup> State law requires county superintendents to monitor the financial performance of school districts and intervene when a district is unable to meet its fiscal obligations. (The CDE does the same for county offices.) Additionally, school districts must retain independent certified public accountants for the purpose of conducting an annual audit as specified by the State Controller’s Office.

Each year districts submit to the county superintendent at least five finance-related documents: the preliminary budget (by July 1); the first and second interim reports that update the budget based on actual revenues and expenditures; an unaudited financial report at the end of the budget year; and the district’s annual audit a few months later.

### The state’s responsibility for districts led to increased oversight in 1991

School districts, dependent upon the state for their revenues, can see their fortunes unexpectedly fall in tandem with those of the state. Such was the case during the recession of the early 1990s. A small—but significant—fraction of the state’s school districts suddenly found themselves in serious financial trouble. County superintendents were supposed to be providing oversight, but they had few tools available to assist them in imposing corrective action in these financially troubled districts. The state experienced several very significant

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<sup>2</sup> Exceptions are the seven counties that have countywide school districts.



district-level financial failures, and in 1991 the Legislature became interested in strengthening county office oversight.

The Legislature's actions were precipitated by legal determinations that the state could not simply allow a school district to go bankrupt. Rather, it had an obligation to step in and, in essence, take over the operations of the district. That determination resulted in the state having to grant sizeable "emergency loans" to troubled school districts. An unwilling lender of last resort, state leaders sought legislation to add teeth to the financial oversight mechanisms already in place.

This was the backdrop for the adoption of AB 1200 in 1991. This bill forced wide-ranging reform in the oversight of school district finances and business practices. Among its many initiatives, the bill created the Fiscal Crisis and Management Assistance Team (FCMAT) to provide both preventative services and recovery assistance to financially troubled districts. It also gave the COEs additional tools and increased responsibility. AB 1200 formalized the process of county review and oversight by which the county superintendent would approve the budget and monitor the financial status of each school district and joint powers authority (JPA) in its jurisdiction. The CDE, in turn, would review the finances of county offices. A county superintendent could impose sanctions on a district along with offers of assistance. For example, if a district failed to meet the state's budget criteria, the county superintendent could enlist the assistance of FCMAT to help solve the problem and prepare a recovery plan. Alternatively, the county superintendent could appoint a fiscal adviser empowered to override decisions of the local board of education.

The new law also established a system for school district accounting practices that specifies how districts must track and report their revenues and expenditures. Districts are expected to do multiyear financial projections; identify sources of funding for substantial cost increases, such as employee raises, and make public the cost implications of such increases before approving employee contracts. It also made explicit the consequences for districts that accept emergency loans from the state in order to avoid bankruptcy.

#### Oversight provisions were further strengthened in 2004

In general, the effect of AB 1200 was timely and significant. For nearly a decade, few districts advanced beyond the stage of increased COE oversight and FCMAT assistance. But legislative change tends to be precipitated by the problems of the day, and the state budget crisis that began in 2001 unmasked yet more problems in a few fragile school districts.

As the state's financial situation worsened after 2000, school districts were increasingly affected by volatility in state funding. It was in that context that a small but significant number of districts simply did not have the financial reserves or systems in place to avoid disaster. After granting the two largest school district emergency loans<sup>3</sup> in the history of the state, and a couple of lesser loans, lawmakers passed AB 2756 in 2004. (See Appendix III for a list of districts that have received state loans since the passage of AB 1200.) This bill added even more teeth to the oversight process by giving COEs more authority and more review time for troubled districts. Additionally, the bill required personal accountability and sign off on district financial documents by both the district superintendent and chief business official.

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<sup>3</sup> These are technically emergency appropriations that the state expects districts to repay.

Passed as an emergency measure, AB 2756 also gave COEs and the state greater ability to monitor the performance of school district auditors and effectively prohibited the use of firms that fail to meet professional standards. Similarly, the state now has the ability to oversee the fiscal oversight role of county offices and remove that responsibility if it is not being done effectively. The bill included the requirement that COEs use a set of specific predictors of fiscal health, developed by FCMAT, as part of their evaluation of a district's budget.

### ***State budget and other external conditions since 2002–03, including enrollment and revenue patterns***

This study examines the fiscal health of school districts based on a variety of factors present from 2002–03 to 2004–05. Demographics in the state vis-à-vis school enrollments began shifting in these years, with some effect on school revenues. Fluctuations in the overall financial condition of the state, which directly affected school district revenues, were more dramatic. The combination of these factors and their interaction over the course of several years was sufficient to push some financially healthy districts into marginal situations and to push some marginal districts into serious financial trouble.

#### **The state has moved from a growth situation to declining enrollments, but impacts vary**

Since the early 2000s, the state has been experiencing a slowing trend in overall K–12 enrollment growth. This trend has not been confined to California but can be traced to broad demographic shifts that have their roots in the post-World War II baby boom. School districts statewide have seen the children of the baby boom (sometimes referred to as the “baby boomlet”) move out of the K–12 system. Indeed, recent enrollment declines have been registered in the state's elementary grades, and this slowdown is expected to make its way through the secondary grades over the next decade.

These and other factors have depressed statewide enrollment, and for the first time in recent memory the 2006–07 State Budget anticipates an actual drop in enrollment (a statewide decline of .26%).

The impact on school districts has been uneven, however, with some districts continuing to grow while others decline. Generally speaking, the hardest hit include remote rural areas of the state that have suffered depressed local economies. Shrinking job opportunities have forced residents to leave these areas for other regions with more promising employment prospects. Schools in turn suffer the loss of student enrollment as families move out. In some coastal regions, families with school-aged children are simply priced out of the housing market. Communities with median home prices reaching \$1 million are not uncommon. In these communities, school enrollment declines because there are an insufficient number of families with young children to replace families who move out or have students who graduate from the K–12 system.

Meanwhile, enrollment growth continues at a strong pace in the areas of the state where many of these Californians are moving. These growth areas are generally characterized by relatively affordable housing. Prominent examples include the Central Valley region in the middle of the state and both Riverside and San Bernardino counties in the south.

## State budget fluctuations have strained districts' fiscal health

In California, where the state controls the bulk of revenues for schools, the general economic and political conditions can have substantial influence on the financial challenges districts face. The years we are examining, from 2002–03 to 2004–05, were particularly volatile. A brief recounting of those dynamics, however, must begin a couple of years earlier with the 2000–01 state budget.

### **From boom to bust in 18 months**

Speculation in the profit potential of new technology generally—and Internet-based companies specifically—fueled a huge increase in State General Fund revenues during the late 1990s. Capital gains and stock option income, which had historically accounted for about 6% of state revenues, increased to almost 25% by 2000–01.

This revenue growth allowed lawmakers to increase funding for many state programs and at the same time provide for substantial tax cuts. K–12 education benefited significantly in the 2000–01 budget, with an increase in unrestricted funding of 10%. While some analysts warned that the revenue increases would not be sustainable over the long term, the Legislature and governor nevertheless budgeted most of the increased spending and tax reductions in 2000–01 as if they were permanent, thus sowing the seeds for the budget and political turmoil that would soon follow.

The 2001–02 State Budget reflected slowdowns in the state and national economies and, more importantly, the collapse of NASDAQ and technology stocks. State tax revenues from capital gains and stock options plummeted as high-tech stocks crashed. In addition, employment and retail sales also tumbled, especially in the San Francisco Bay Area. Within 18 months, a major state revenue surplus turned into a major shortfall. The Department of Finance forecast a budget gap of \$12 billion. This would be the first of three extremely difficult years for school districts, and it included for the first time ever mid-year cuts in state funding for K–12 public education.

### **Budget issues helped unseat a governor**

The following year's contentious budget negotiations delayed the signing of the 2002–03 Budget Act by Gov. Gray Davis until Sept. 5, 2002, more than three months after the start of the fiscal year. The 2002–03 spending plan for K–12 education saw a continuation of reductions and deferrals instituted the year before. It also included a variety of “one-time fixes” that did not address the underlying imbalance between revenues and expenditures. While Proposition 98 was technically fully funded, the minimum guarantee level had dropped as a result of the decline in state revenues. K–12 education endured cuts to a variety of programs plus major funding deferrals. The one bit of good news for 2002–03 was that the state funded a 2.0% cost-of-living adjustment (COLA) for revenue limits, special education, and other categorical programs—a rate that exceeded the 1.66% required by law.

The challenge facing the Legislature and the governor as they developed the 2003–04 budget was in many ways more difficult than what they had faced in the prior two budgets. In addition to struggling with the persistent gap between ongoing revenues and expenditures, lawmakers faced a statewide energy crisis that had drained billions from the state General

Fund, forced a major public utility into bankruptcy, and ignited a recall movement aimed at Davis, who had just won a second term. The state's fiscal crisis was not lost on national observers, as Standard and Poors downgraded California's credit rating to BBB, a level that only one other state in the nation's history had fallen below.

For 2003-04, the K-12 education budget reflected a 3% deficit on revenue limits (an unfunded statutory COLA of 1.8% and a real cut of 1.2%). Cuts in categorical programs were even larger. But officials also acknowledged the fiscal burdens the situation placed on school districts. To provide more flexibility, the Legislature authorized districts to access funds normally required to be held as ending balances, temporarily reduce their required Reserve for Economic Uncertainties, and reduced their contribution toward routine restricted maintenance.

Ultimately, the ongoing problems with the state budget, coupled with the energy crisis, took their toll on California's most visible leader—the governor. On Oct. 7, 2003, state voters recalled their governor, making Davis only the second governor in the nation's history to be recalled from office. At the same time, voters elected Arnold Schwarzenegger to succeed Davis. One of the new governor's first tasks was to prepare a proposal for the 2004–05 budget.

### **Continuing budget imbalance leads to 2004–05 suspension of Proposition 98**

The 2004–05 State Budget was enacted on time, but it made little progress in closing the state's structural budget gap. Like budgets signed by his predecessor, Gov. Schwarzenegger's first budget ultimately relied more heavily on borrowing and fund shifts than on budget cuts or new revenues.

For K–12 education, the 2004–05 budget included a fully funded 2.41% statutory COLA and some other funding increases, but it did not restore the cuts imposed in prior years. Perhaps most significantly, the 2004–05 State Budget included a provision that became known as the “Deal.” This historic agreement between the administration and the education community called for a \$2 billion limited suspension of Proposition 98.

Disagreements about the interpretation of this provision and its implications for education funding tainted the budget development process the following year and left lingering uncertainty for school districts throughout the 2005–06 school year. That is the timeframe in which school district chief business officers were surveyed for this study.

As this brief account makes clear, the years from 2002–03 to 2004–05 presented some extraordinary challenges to school districts as they attempted to manage responsibly and keep their districts fiscally healthy. To some degree, it could be considered a credit to the ability of district leaders that only a few suffered severe financial setbacks. However, this feast-famine cycle seems to recur on a regular basis. It is thus part of the context within which California school districts must operate. And while the vast majority of districts weathered this turmoil, some spectacular failures succeeded in getting the attention of lawmakers and the public.

### ***Emergency loans and other measures for distressed districts***

From 2002–03 to 2004–05 county and state officials identified 29 districts that had fiscal health problems serious enough to require intervention. Of these, 26 districts received a negative certification under AB 1200 provisions. More seriously, three school districts—West Fresno Elementary, Vallejo City Unified, and Oakland Unified—received emergency loans from the state totaling more than \$116 million.

These loans triggered a set of sanctions and controls prescribed by law. When a district receives an emergency loan, local control is ceded to the state. The superintendent is terminated, and the elected board members lose their powers, plus any compensation or benefits they normally receive. The state appoints a state administrator to serve, in effect, as both the board and the superintendent.

Once the district, after a period of years, stabilizes its budget including the payments on the loan, the process of return to local control begins. This process may mean reinstating some or all of the board’s powers. Additionally, a new superintendent may be appointed, in which case the state administrator will be replaced by a state trustee. The trustee oversees the actions of the board and the superintendent, and retains the power to overrule and set aside board decisions. This level of oversight continues until the emergency loan is paid off. Emergency loans may have a repayment schedule of 20 years or more, so the additional oversight can continue for a very long time.

## **Best practices in district financial management**

California’s process of certifying school districts’ ability to meet their obligations—and the resulting interventions—have generated a body of knowledge regarding many of the practices and policies that distinguish fiscally healthy districts from those that are either struggling or unhealthy. California’s experience appears consistent with professional standards for school district financial management found elsewhere.

### ***California has focused on indicators that predict a problem***

FCMAT staff have developed a brief compendium of the school district problems they most commonly encounter when a district is identified as having fiscal problems—“FCMAT Predictors of School Agencies Needing Intervention” (see Appendix II). These are organized into overarching categories, several of which fall under the general purview of the district CBO. Those include:

- an inadequate budget development process,
- limited monitoring of the budget following adoption,
- inattention to costs and requirements related to categorical programs, and
- substantial long-term debt commitments.

Another set of predictors, while sometimes within the span of control of the CBO, are often managed by other district administrators. Those include:

- the collapse of the district’s physical infrastructure,
- ineffective management information systems,
- poor control over personnel positions and hiring, and
- a human resource crisis, including staff shortages.

Finally, the FCMAT list includes two categories that are clearly not within the CBO's control:

- a leadership breakdown, including a governance crisis (such as a school board recall); and
- ineffective communication, particularly to the larger education community.

California lawmakers used this FCMAT list in 2004 when they wrote AB 2756 to strengthen the fiscal oversight function. The law requires that county superintendents use 15 predictors developed by FCMAT as one basis for evaluating a district's adopted budget. If an external reviewer has found more than three of the following in evidence, the county superintendent must withhold budget approval unless the district can provide adequate assurances that it is able to meet its financial obligations. The official list of 15 predictors is as follows:

- governance crisis,
- absence of communication to educational community,
- lack of interagency cooperation,
- failure to recognize year-to-year trends,
- flawed average daily attendance (ADA) projections,
- failure to maintain reserves,
- insufficient consideration of long-term bargaining agreement effects,
- flawed multiyear projections,
- inaccurate revenue and expenditure estimates,
- poor cash flow analysis and reconciliation,
- bargaining agreements beyond the state COLA,
- no integration of position control with payroll,
- limited access to timely personnel, payroll, and budget control data and reports,
- escalating General Fund encroachment, and
- lack of regular monitoring of categorical programs.

County offices are in the early stages of implementing these new review procedures and applying them to specific situations. The list, which includes many relatively subjective judgments, was further supplemented by actions of the State Board of Education in July 2005. Taken together, the intent is to create a holistic picture of a district's situation that goes beyond discrete measures and that provides improved guidance to COEs as they discharge their oversight responsibilities.

California's general approach is aimed at identifying bad situations. In a more constructive vein, documents from the Association of School Business Officers International (ASBO) and from other states recommend some professional standards for school district CBOs. They also address district financial management and governance more generally.

Of particular interest for this study was Florida's *Sharpening the Pencil* program. Enacted in 2001 through that state's Office of Program Policy Analysis and Government Accountability, the program was an attempt to systematically improve school district financial management practices. It also was intended to improve districts' use of resources and to identify cost savings. As originally envisioned, the program required each school

district to undergo a Best Financial Management Practices Review once every five years, and it included a set of documents that provided a checklist of both legal and professional standards for that review.

Due to budget constraints, the Florida Legislature has not appropriated funds for the *Sharpening the Pencil* program since the 2003–04 fiscal year. The documents, however, remain a valuable resource for examining district financial practices, most of which can be generalized to school districts anywhere, not just in Florida. They encouraged school districts to:

- use performance and cost-efficiency measures to evaluate programs;
- use appropriate benchmarks based on comparable school districts, government agencies, and industry standards to assess their operations and performance;
- identify potential cost savings through privatization and alternative service delivery; and
- link financial planning and budgeting to district priorities, including student performance.

The program has been recognized by the National Legislative Program Evaluation Society of the National Conference of State Legislatures and by the American Society for Public Administration’s Center for Accountability and Performance.

In March 2006 ASBO published *International School Business Management Professional Standards and Code of Ethics*. This document “evolved from a combination of existing standards (2001), the knowledge base in the field, and the input of highly trained and well-recognized school business officials.”<sup>4</sup>

### ***Comparing school district and business management***

The contrasts between school district financial management and business management are numerous. In “Promoting a Management Revolution in Public Education,” Stacy Childress (et al) underscores these differences:

...while public school districts have a myriad of managerial, leadership, and organizational concerns, they are not businesses. In reality, their differences are greater than their similarities. The way they acquire capital, their mandate to serve all students (customers) regardless of their capabilities or desires, and their accountability to a multiplicity of public and private stakeholders, who often have conflicting interests, are but a few examples.”

A number of additional requirements for school districts that are particular to California can be added to this more general comparison. These include the requirement to collectively bargain with employees should they choose to be represented, due process protections for employees that can make the cost of termination substantial and the process lengthy, and limitations on the ability to contract with outside vendors for services.

At the same time, many school districts can and do adhere to business practices that improve their efficiency and reduce their costs. That can include strategic planning,

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<sup>4</sup> ASBO, March 2006, page 3.

competitive bidding, and best practices in the area of personnel management, including hiring, evaluation, and progressive discipline. Districts can also approach their interactions and communications with families and communities constructively, treating them as the “clients” of the education business. Effective investment strategies can ensure that districts maximize earnings on cash balances and other investments, manage real property well, and use effective management information systems. Some school districts also gain important advantages by forming joint powers authorities (JPAs) for purposes of combining purchasing power, providing services, or sharing risk.

### Fiscal control issues are a particular challenge for school districts

In theory, the basic principles of fiscal control in school agencies should differ little from those in other enterprises. In practice, however, fiscal control is much more complex for a number of reasons, in part because it must extend far beyond the district office or the business department.

Decentralized decision-making across a large district means that financial controls must be in place at every level in the district, including at school sites. With the sometimes rapid turnover of school site personnel and the difficulty of maintaining consistent standards of training, there are many opportunities for breaches of fiscal control. Separation of duties, a basic tenet of internal control, may be difficult in small districts and even more so in smaller schools. Given this backdrop, school agencies often adjust to the situation with a complex set of procedures.

A school district’s elected board also has substantial influence over the quality of its fiscal controls. The board can implement policies that require fiscal accountability and insist that they be followed. Those policies include board approval of budgets, contracts, bids, warrants, personnel actions, and many other areas that lead to fiscal obligations. Boards also vary in their commitment and capacity to monitor the district’s budget. Effective monitoring requires board expertise and a commitment by district administrators to provide information that is accurate, timely, and relevant.

An inescapable reality for every school district is that the bulk of expenditures are for personnel. That fact, combined with California state law in regard to collective bargaining, means that district negotiations with employee unions are central to a district’s ability to keep its expenditures in balance with its revenues.

### ***Compensation issues are central to school district finances***

Collective bargaining is mandatory for school districts in California. Since passage of the Rodda Act in 1975 (SB 160), school districts are required to recognize and bargain with the union that has been certified as the exclusive representative of that particular employee group. While certain employee groups in a few districts have not held representation elections or designated an exclusive representative, the vast majority of California school districts are totally unionized.

A typical district will have at least two bargaining units, one for teachers and one for classified employees. Some districts also have bargaining units for a portion of their administrators, such as school principals. The prevalent unions for teachers are the California



Teachers Association (CTA) and the California Federation of Teachers (CFT), with CTA representing by far the larger number of California teachers. Teachers in Los Angeles Unified School District have a separate organization, United Teachers of Los Angeles. For classified employees, representation is provided by a number of employee organizations, including CFT, the California School Employees Association (CSEA), the Service Employees International Union (SEIU), and several others.

Many districts have more than two bargaining units. Often CSEA, for example, will have two or more separate units in the same district. One unit might represent food service workers, another clerical workers, and yet another maintenance workers. A large district may have even more individual bargaining units. The district has an obligation to bargain in good faith with each of them.

### The scope of bargaining covers more than salaries and benefits

The scope of bargaining is defined partly by state law and partly by local contract and past practice. Wages, benefits, representation, and working conditions are all specified by state law as mandatory subjects of bargaining. It is very common for the scope of bargaining to include class sizes, coaching stipends, paid planning time, compensation for after-school activities, number of teaching minutes, duty-free lunch periods, retiree benefits, employee transfer and reassignment policies, and processes for evaluation and termination of employees.

In some districts, the scope of bargaining is narrow and the process well defined; in others, the scope is very broad and negotiations are an ongoing process. There are districts in which nearly every area of personnel management is part of the union contract either because the term “working conditions” has been broadly interpreted or because the parties agreed to expand the scope.

### Collective bargaining and dispute resolution both follow a set process

The normal bargaining cycle begins a few months before expiration of the current labor contract when the parties each submit a list of proposed changes called an initial bargaining position. Depending on the district and the year, this can address the full contract or just specific “re-openers,” such as salary and benefits. California state law requires districts to renegotiate their full contract every three years. These initial bargaining positions are “sunshined” at a public meeting of the board of education.

The parties designate negotiating teams to represent both the board and the union. While it can vary widely, negotiating teams often have five or six members on each side. Both parties may and do use outside negotiators to represent them at the table, though many districts and unions prefer to handle the entire process on their own.

Whether through a traditional positional bargaining process, wherein proposals and counterproposals are exchanged, or through a more collaborative form of interest-based bargaining, the parties negotiate each open article and eventually reach a tentative agreement.

For the agreement to become final, it must be ratified by a vote of both the union members and the board. If either side fails to ratify, which does happen, the tentative

agreement fails and the parties go back to the table. A large majority of districts reach agreement with their unions using this process, but each year a few do not.

In California, unlike some other states and the federal government, public employee unions have the right to strike and the district has the right to unilaterally impose its last, best, and final offer. But prior to taking a serious job action, or initiating a unilateral implementation, the parties must comply with specified state processes, including a declaration of impasse, mediation, and fact-finding. (See Appendix for more on this process.)

In California, there is no binding end to negotiations short of a bargained agreement, and neither the board nor the union is compelled to reach an agreement.

Once an agreement is reached, however, state law requires that the district superintendent and chief business official personally certify that the district can afford the cost of the agreement for its duration. The COE then reviews the agreement and may advise the board of any concerns.

### Compensation is determined locally but within state guidelines

California does not have a statewide salary schedule for school district employees; compensation decisions are made at the local level. As a result, no two districts use exactly the same compensation scheme.

The components of compensation include:

- salary,
- number of duty days and hours of work,
- health and welfare benefits,
- statutory benefits, and
- postretirement benefits.

Additionally, negotiation of working conditions can affect the cost of compensation. For example, a decision to lower class sizes results in the hiring of more teachers and raises total compensation costs.

Salary is negotiated as a major part of current compensation. Base salary is, however, quite complicated. In the case of teachers, California requires base salaries to be based on seniority and educational qualifications. Each district must place all teachers on a single salary schedule based upon those two criteria. The specifics of the schedule are locally bargained. A typical schedule is comprised of seniority steps and columns for educational units. Some districts have very few steps, and beginning teachers move from the lowest to the highest step in less than 10 years. In other districts, it takes up to 40 years to reach the highest step. Some districts add stipends for various accomplishments or activities, such as advanced degrees, specific assignments, and extra duties.

Compensation also includes days and hours of work. The state requires schools to offer 180 days of instruction, with a minimum number of minutes per day based on grade level. However, districts vary in their expectations of teachers in these areas. For example, some districts require teachers to be in the classroom teaching five hours per day for 180 days each year. Others require 186 or 187 days and perhaps a 5 1/2-hour teaching day. A shorter work

year or duty day often means that costs will be higher for the district and the amount of money available for direct teacher compensation may be lower.

Health and welfare benefits are another major component of compensation. Many districts and their bargaining units choose to offer free, or nearly free, health benefits. Often these benefits are extended, at no cost, to dependents and are also extended into retirement. Effectively, a decision to take compensation in the form of benefits is a decision not to take increased salary. Some districts, in recognition of this, cap benefits at a certain level and negotiate new dollar allocations to both salary and benefits. But it is a zero sum game: lower benefit costs lead to higher salaries and vice versa.

Statutory benefits are an “automatic” but substantial cost to school districts. For each employee, the district is required to contribute to specified public employee retirement programs, unemployment, and Social Security/Medicare for some employees. These costs total more than 12% of salary.

### Retiree health benefits are a growing concern

Postretirement benefits, particularly healthcare benefits, are relatively common in school agencies. Most districts that offer such benefits have a maximum number of years or age to which the benefits are offered. A small number, however, offer benefits for life, often including a retiree’s spouse and acquired dependents. The cost of lifetime benefits is dramatically higher than those offered for a limited period.

California school districts are neither required nor prohibited from offering postretirement health care benefits to former employees. If they choose to offer such benefits, the district is not required to pre-fund any part of the benefit; and most districts do not. This means that a district can effectively grant a costly benefit to current employees and in the future have to balance that cost against a desire to augment educational programs or increase staff compensation.

Prior to the formulation of the Governmental Accounting Standards Board (GASB) statements 43 and 45 in 2004, districts were not required to include any acknowledgement of the liability for postretirement benefits in their financial statements. A footnote referencing the actuarial value of the unfunded benefit was sufficient to meet disclosure requirements.

Upon implementation of GASB 43 and 45, the disclosure level will be increased. Beginning with the largest districts in 2006, districts will in coming years be required to record the unfunded liability in their financial statements. There is still, however, no requirement that a district set aside funding to pay for the future benefit. A district could continue to allow the liability to grow with no pre-funding; and no matter how large the liability becomes, they would not be required to fund it. This is far different than for private corporations, which are required to fund such benefits.

Along with the discretion to fund or not fund the liability, the district also has the ability to determine the nature of the benefit offered. In practice, most plans require coordination of benefits with Medicare when eligible; but some do not. While many California school districts offer a zero benefit—and a few offer the most costly benefit—most districts fall in the middle.

Benefits to a certain age or for a certain number of years are far less problematic than those offered for life. Actuarially, a disproportionate share of lifetime health-care costs occur during the final year of life. Districts that terminate the benefit or transition former employees to Medicare at age 65 avoid some of that cost.

Once given, the postretirement health benefit is very difficult to take away. Districts that have done so have typically established a two-tier system. Employees hired before a certain date have the benefits; those hired after that date do not. The district's operating budget is still burdened with the cost of paying for the benefits for those employees who do have them, which can limit other expenditures such as salary increases. The employees who continue to have the larger postretirement benefits typically include all current retirees and all current employees hired before the specified date. Thus the district can expect a substantial outlay for postretirement benefits for 40 or more years into the future even if it stops offering the benefit to new employees.

Finally, the cost of health benefits has risen at a rate that is two to five times higher than revenue increases in school districts. The unfunded liability thus grows at a rate far in excess of the district budget. Over time, both the unfunded liability and the cost to service pay-as-you-go benefits have become larger percentages of the district's financial resources.

### ***Facilities management involves both capital and operating funds***

School buildings are integral to district operations, yet much of the financial management related to them is outside of district general fund budgets. In California, the capital investment in buildings, including both new construction and modernization, is financed through completely different sources than those used for general operations. For the most part, a combination of local and state bond money pay for facilities construction and major modernization, in part because of the state's requirements that districts provide a local match for state bond proceeds. Exceptions to these matching requirements are sometimes made for hardships and emergencies.

The ongoing maintenance of facilities, on the other hand, comes out of district operating funds in ways that are partially mandated by state law. Districts are required, for example, to maintain a Routine Restricted Maintenance Fund that dedicates 3% of their general fund budget to this purpose. In addition, they can receive state funds for deferred maintenance projects as long as they provide matching local funds.

The routine cleaning and upkeep of facilities—custodial work in other words—cannot be funded from the above sources. Instead, it is charged to the general fund.

As public entities, school districts are also legally required to comply with the Civic Center Act and allow use of their facilities by the public. Some groups are required to pay the full cost of use, and others are allowed to use the facilities for free. These arrangements are handled at the local level, and districts vary in the requests they get, the fees they charge, and the number of obstacles they sometimes place in the way of such use.

Additionally, school districts are free to engage in asset management programs and use excess property to generate additional revenue. This most commonly involves leasing vacant school sites. Some school districts are large property owners within communities, and they

may within certain limitations also sell some of their holdings in order to raise funds for other purposes. However, this is generally one-time money and does not provide a dependable source of ongoing income.

## **The financial management responsibilities and capacity of district leaders**

School district financial management is not one person's responsibility. Rather, it is shared between school district governing boards, superintendents, and CBOs.<sup>5</sup> Generally, CBOs are responsible for developing and managing the technical details of the budget, monitoring fiscal activities, and advising the board and superintendent on the fiscal well-being of the district.

California law requires that the superintendent and the board review and ultimately approve the budget and other fiscal information submitted to local county offices of education and/or the California Department of Education. When superintendents and boards affix their signature to financial reports, they are saying they agree with and support the information provided. For this reason, not only CBOs, but also superintendents and board members need to be knowledgeable about financial management laws and practices.

California does not currently have any official requirements for the certification of CBOs. Districts are free to hire whomever they choose in this role, and the state does not regularly collect data regarding the education or experience of district CBOs. Anecdotally, we know that many CBOs have prior professional or educational experience in finance-related disciplines, such as accounting and business administration. There are also some that have worked their way up through the district, starting out as classroom teachers and/or school administrators.

In other states, the certification requirements for CBOs vary. According to surveys conducted in spring 2003 by ASBO with Purdue University, 14 states require some form of certification or licensure for CBOs, another 14 have voluntary certification, and 20 have neither type of program. (Two states did not respond to the survey.)

### ***Superintendents and board members play important roles in financial management***

Each California school district varies slightly in how responsibilities and processes relating to financial management are organized. For every district in which the superintendent is heavily involved in creating the budget, for example, there is likely to be one with a superintendent who takes a laissez-faire approach. The same range of involvement holds true for board members. In addition, some districts have a high level of public involvement and scrutiny—including perhaps a budget advisory committee—while others receive almost no public input even though they hold the required public hearings.

The capacity of these leaders to oversee their district's financial operations is clearly important. A variety of organizations in the state provide training and support for them, including the major membership organizations for administrators and school board members

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<sup>5</sup> Some California districts have directors of fiscal services who are not considered chief business officers.

respectively—the Association of California School Administrators (ACSA) and the California School Boards Association (CSBA). Both superintendents and board members also depend on services and training from two other organizations, the nonprofit California Association of School Business Officers (CASBO) and the for-profit consulting firm School Services of California (also co-author of this report). Districts pay for these various services through their regular budgets; the state does not provide any incentives or reimbursements. FCMAT also provides management assistance upon district request in addition to performing its duties related to negative-certified districts.

An assessment of the quality, cost, and availability of formal school finance training for superintendents and school board members is outside the scope of this study. Given the pivotal role that these leaders play in financial management of school districts, however, it should be a topic of interest for state leaders.

### ***Attention has been directed at improving the capacity of CBOs***

In California, there has been increased recognition that effective district leadership requires that CBOs in particular have sound knowledge of good fiscal management practices. The growing number of districts nearing or reaching fiscal insolvency (see above discussion of AB 1200) ultimately prompted legislative action in 2005–06. Prior to that, the state had no specific policies regarding training or qualifications for CBOs. This action followed several years of work on the part of both state officials and the education community.

In 2002 CASBO convened a task force to discuss potential solutions to the lack of certification and training for the state’s school business officials. As a result of the task force recommendations, CASBO sponsored SB 850. This legislation would have authorized FCMAT to develop and conduct training programs leading to certification. However, as the fiscal reality began to worsen for the state in general and for public education in particular, SB 850 was shelved for another session.

The issue did not again gain statewide recognition until the release of the California Performance Review (CPR) in summer 2004. The CPR Commission’s report recommended collaborative work between the secretary for education, the superintendent of public instruction, and agencies such as FCMAT, CASBO, ACSA, and the Department of Finance to establish standards for professional competence, identify possible certification routes, and examine the potential effect on recruitment.

CASBO again sponsored a CBO training bill, SB 352, which passed the Legislature in 2005 and was supplemented by a \$1 million ongoing budget augmentation. The program provides \$3,000 per candidate to attend one of several approved training programs (enough for close to 350 participants annually).

The 2005–06 school year was spent preparing for the implementation of the training program. In March 2006 the State Board of Education approved criteria for training providers, and the CDE invited organizations to apply to become state-qualified trainers. Between May and July, the CDE announced the six providers that were approved. A seventh provider was under consideration at the time this study was written. In addition, 350 training candidates were reviewed by CDE and recommended to the SBE. As of July 2006, 209 had received approval.

The legislation further required that the CDE provide both an interim and final report on the program. Included in the interim report, due in July 2007, will be the “identification of the core competencies that should, at a minimum, be included as part of a state-administered chief business officer certification.”<sup>6</sup> The legislation does not, however, call for that certification to be implemented.

Previously, private organizations and FCMAT provided the CBO training available in California, and individuals or school districts generally paid for it. There were four primary options available. This study asked respondents about the extent to which they participated in those programs.

## **Linking resource allocations to educational objectives**

In this era of standards-based accountability, the challenge of connecting resources to performance goals has begun to gain serious attention among some policymakers, members of the public, and educators. The idea that public schools and districts should strategically connect what they spend to their most salient student outcome goals gained support from a somewhat unlikely place, the Governmental Accounting Standards Board (GASB). GASB called on government financial reporting to “help users assess the economy, efficiency, and effectiveness of government” (Fountain, 2001).

The subsequent call for developing accurate performance measures eventually led researchers to urge governments, including education entities, to manage for results. This research emphasized the use of an organization’s strategic and program plans—especially those aimed at specific performance results—as a basis for allocating resources.

That recommendation, however, runs counter to a deeply entrenched reality. Public school spending decisions have traditionally been based on set staffing and expenditure formulas. And historically those formulas have had—at best—a limited relationship to district performance goals. Categorical funding attempts to earmark a portion of school district expenditures for strategic purposes, and in recent years No Child Left Behind (NCLB) has illustrated the extent to which the state and federal governments can leverage those dollars toward that end. Yet here too it is unclear that the resources are actually used in ways that further district performance goals. That gap between expectations and reality is likely attributable both to the abilities of school district managers and the complexity of the task they face.

In California, about a third of operating revenues are earmarked through dozens of separate programs, each of which has attendant rules and expectations. School and district officials vary in their capacity to manage these multiple funding sources effectively, much less strategically. One indicator of demand for assistance in this area is the annual sessions provided by School Services that offer training to school districts on the rules, regulations, and effective management of categorical resources. In 2005–06 more than 1,350 people, representing more than 400 education organizations, attended these sessions.

Increasingly, critics are calling for changes in this traditional approach to funding California’s schools. But recommendations vary in regard to what the relationship is between

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<sup>6</sup> California Senate Bill 352, filed Sept. 28, 2005.

resources and school performance, what a better resource allocation system would look like, and whose interests might be best served by various proposals.

One common theme in this discussion is the desirability of putting resource allocation decisions closer to the classroom and the students. In large urban districts, such discussions often focus on school-based decision-making based on the theory that those nearest to the instructional relationship are in the best position to determine how to use resources strategically to improve instruction. Advocates argue that if greater accountability for results accompanies this flexibility, schools will operate more efficiently and students will be better served. Few examples exist, however, to substantiate these theories. A handful of large urban districts have attempted to move to a site-based allocation system, typically using a “weighted student formula” (WSF). This approach to WSF is based on the idea that money should follow the child and that larger amounts should be allocated for students with greater needs. With the possible exception of Edmonton, Alberta (where a WSF approach has been in place for about two decades), the results have been mixed at best. Critics of this allocation approach point to this lack of evidence. They also raise concerns about the capacity of school leaders to manage resources effectively and point out the advantages large districts have because of economy of scale. Recent research about the vital role of school districts in instructional improvement adds additional perspective regarding the important role districts can play.

A few states are experimenting with funding systems that tie allocations more directly to students or goals. In Hawaii, where the state has a single school district, a new funding system was implemented in 2005–06 based on having the money follow the student. It is too early to evaluate the effectiveness of the reform. Two states, Arkansas and Wyoming, have recently implemented statewide school finance reforms based on evidence that connects funding to specific strategies for resource allocations. Developed on the basis of work by Allen Odden and Larry Picus, these reforms are also quite recent. The states are now working on ways to measure how well districts implement the change, and it will be at least two years before any definitive findings are available.

Another interesting research effort now underway highlights the complexities involved. This effort, called the Public Education Leadership Project (PELP), involves professors from both the schools of business and education at Harvard University. In a July 2005 working paper, the authors argue that schools cannot simply be “run more like a business.” Instead, they contend: “School districts today face unique challenges that make them more difficult to lead and manage than virtually any other enterprise in our country” (Childress et al., p. 2).

PELP has just begun to explore the challenges that exist in linking school district management to educational outcomes. Their findings may help illuminate future research, but like much of the work in this area, their focus is on the needs and challenges in large urban districts. In California, the discussions and options are even more complex. As of 2004–05, about 24% of students attend school in the state’s largest 10 districts. Another 74% attend school in midsize districts that serve between 1,000 and 50,000 students and may have anywhere from one to about 75 schools. Further, 224 school districts in California are single-school districts, meaning that the district and school are in effect the same entity. The state also has more than 600 charter schools. In such a context, it is much more difficult to say what allocation approach would represent best practice or even a general goal worth pursuing.



This study’s examination of these questions was purposely limited. It looks at the extent to which the concepts of strategic resource allocation and site-level decision-making have salience among California school districts, at least as reported by their chief business officers. Having a clear picture of what exists in the state in this regard—both in terms of attitude and practice—is of value as a starting place for further research and debate.

## Data and methodology

This study was initiated to address three central questions:

- What relationship exists between the fiscal health of California school districts, the conditions under which they operate, and their personnel, practices, and policies related to fiscal management?
- To what extent are districts successful at increasing their revenues and who in the district seems to be responsible for that success (where it exists)?
- What practices are most common in school districts in relation to the strategic allocation of resources, in particular the allocation of resources to school sites?

While the state of California collects a broad range of data regarding public school operations and finances, it was immediately clear that we would need to develop additional information in order to address these questions. A survey of chief business officers in a sample of school districts was our central strategy for gathering the information we needed. The survey responses could then be combined with state-collected data about districts to illuminate our central questions.

### **Survey development and content**

The survey development was informed both by research and the expertise of our team, which together helped us identify both legal requirements and professional standards related to school district financial management. Of particular importance were numerous publications by FCMAT (in particular, *Predictors of School Agencies Needing Intervention*), Florida’s *Sharpening the Pencil* program, and both the *Financial Accountability System* and the *Financial Integrity Rating System of Texas* (FIRST).

Florida’s *Sharpening the Pencil* program, from that state’s Office of Program Policy Analysis and Government Accountability, was the most detailed example of an effort to improve school district financial management practices and use of resources as well as identify cost savings. The program, which was never fully implemented, would have required each school district to undergo a Best Financial Management Practices Review once every five years. That review document was an important source for us in developing our survey.

ASBO published a comprehensive professional standards document after the survey instrument was completed. An examination of its content, however, showed that the professional standards it developed are consistent with those we had identified and that formed the heart of our survey questions.

(For a more complete list of research used, see the bibliography at the end of the study.)

Our initial survey draft was then reviewed by staff at EdSource, School Services of California, and FCMAT to tailor it as necessary to the realities CBOs face in California. Professor Susanna Loeb at Stanford University reviewed the document for both its content and construct. As a further check, we asked several individuals with CBO experience to pilot the survey. We made final edits based on their feedback.

Our survey was of CBOs, and thus our questions were specific to their duties and scope of responsibilities. That limited the extent to which it could explore issues related to financial management that are outside the CBO's purview, such as the background of the superintendent and school board or the capacity of other district administrators. We also did not depend on survey responses when we knew statewide data was available (see the list below). The final survey instrument focused on questions related to: the responsibility of business officers; governance and administrative structure and practices; financial information and cost controls; retiree health benefits; management of specific operations; collective bargaining relationships and processes; maximizing district revenues; allocation strategies and decision-making; general observations; and qualifications of district CBOs. (For a copy of the survey please refer to Appendix I.)

### ***Sampling methodology***

In January 2006 the team began to discuss the criteria by which we would select a sample of school districts. The goal was to have a random sample that was representative of the 979 school districts in California in terms of financial management practices and risks to fiscal health.

School districts in California vary across a broad range of characteristics. However, we concluded that stratifying our sample by district size alone was appropriate. First, we believed that district size—more than most other characteristics—affects the manner in which financial management is done. Further, we believed that sampling by size would naturally result in a reasonable representation of districts of different type (elementary, unified, or high school district) and from throughout the state. We were also concerned that we not overload our sample with small school districts, given that the largest number of California school districts are quite small.

We ordered districts statewide using the following size categories based on their enrollment:

- less than 1,000,
- 1,000 to 4,999,
- 5,000 to 9,999,
- 10,000 to 19,999,
- 20,000 to 30,000, and
- more than 30,000.

Working with these size categories, and in consultation with Professor Loeb, we developed a sampling matrix to facilitate the selection of a random stratified sample of 198 districts to take our survey. We agreed to send the surveys to an equal number of districts from each size category. This sampling would, in effect, include fewer small districts and more large districts in proportion to their absolute numbers. In the process, it assured a robust

group of our respondents would represent those districts that serve the majority of California students.

Out of our 198-district group, we further decided to include an oversample for two categories of districts that represent unusual circumstances and relatively small numbers. In both cases, we wanted to make sure we had adequate representation in our sample given the small portion of districts in either category statewide. The first was basic aid school districts, of which there are about 50 in the state. These districts operate on a different revenue system than other districts, and we were interested to see if they differed from other districts in terms of their financial management. We included 20 basic aid districts in the sample, and 16 of them responded to the survey. The second category was districts that, through the state's budget review process, had been officially identified as having fiscal difficulties by receiving either a negative or qualified certification. To assure that we had a sufficient number of these districts to evaluate our findings against fiscal health, we purposely included in our sample 30 districts that had received these certifications between 2002–03 and 2004–05. A total of 17 responded.

We also made sure the state's largest school district was in our sample as it holds unique importance as the educational agency for about 11.5% of the state's students. Out of the 198 districts sampled, 23 respondents were from single-school districts, many of which were direct service districts. We had 14 single-school districts respond.

In addition, we explicitly excluded from the sample the four districts that have received emergency loans from the state since 2001 (West Fresno Elementary, Vallejo Unified, Oakland Unified, and Emery Unified). The research group believed that these were outliers and would skew the data from our sample. We also excluded all county offices of education.

### Recruiting districts for study participation

EdSource oversaw mailing the surveys to districts and securing their participation in the study. We tapped into our 29-year history of strong relationships with districts—and recent experience with two similar survey retrieval processes—for this effort.

In March 2006, EdSource and School Services together sent a letter to the superintendents in our sample districts introducing the study. We then mailed the survey in April to the CBO in each district. These mailings were followed by phone calls from EdSource and School Services as necessary to make sure the intended respondents were aware of the survey and strongly encouraged to participate. The retrieval process was completed the first week of June 2006.

Out of the 198 surveys mailed out, 136 were returned. We excluded one survey because it was sent to a joint administration district (separate elementary and high school districts that have a shared administration) but was completed by only the elementary branch. The final sample size after this exclusion was 135. The table below shows the return rate by district size and reflects the district status for which we oversampled.

**Table 2: Surveys Returned**

<b>District Size (2004–05)</b>	<b>Total</b>	<b>Basic Aid Districts</b>	<b>Negative Certification</b>	<b>Qualified Certification</b>
Less than 1,000	24	7	2	1
1,000 to 4,999	28	6	0	4
5,000 to 9,999	24	1	1	3
10,000 to 19,999	19	1	0	2
20,000 to 30,000	21	1	1	1
More than 30,000	19	0	2	0
<b>Total</b>	<b>135</b>	<b>16</b>	<b>6</b>	<b>11</b>

Our final group of respondents varied from districts statewide in a number of ways, which the table below illustrates. But while it is not strictly representative across these characteristics, we believe that it provides a good cross section of districts in terms of financial practices, the subject of our enquiry.

**Table 3: Statewide and Sample District Characteristics (2004–05)**

<b>District Characteristics 2004–05</b>	<b>Statewide</b>	<b>Sample</b>
<b><u>District Size</u></b>	% of districts in state as a whole	% of districts in sample
Less than 1,000	43.8%	17.8%
1,000 to 4,999	28.4%	20.7%
5,000 to 9,999	13.0%	17.8%
10,000 to 19,999	7.7%	14.1%
20,000 to 30,000	3.9%	15.6%
More than 30,000	3.2%	14.1%
	% of student enrollment in state as a whole	% of student enrollment in sample districts
Less than 1,000	2.1%	0.4%
1,000 to 4,999	12.2%	3.1%
5,000 to 9,999	16.0%	6.9%
10,000 to 19,999	19.0%	11.2%
20,000 to 30,000	15.7%	19.2%
More than 30,000	35.2%	59.2%
	<b>Statewide</b>	<b>Sample</b>
<b><u>District Type</u></b>		
Elementary School	56.8%	34.1%
Unified	33.9%	54.8%
High School	8.5%	10.4%

<b>Student Demographics</b>		
% English Learners (ELs)	17.7%	19.0%
% Free/Reduced-priced meals (FRPM)	19.6%	5.3%
<b>Revenue Levels</b>		
Average Revenue Limit per ADA (2002–03 to 2004–05)	\$6,000	\$5,797
Average Total Revenue per ADA (2002–03 to 2004–05)	\$8,964	\$8,125
<b>Other</b>		
Basic Aid	5.4%*	8.9%
Negative Certification	2.5%	4.4%
Qualified Certification	10.4%	8.1%

Columns may not add to 100% due to rounding.

\*About 50 districts are in this group year after year, but the total of basic aid districts in any given year can be as high as 80.

### ***State data sources***

To supplement our survey responses, we also gathered a variety of data from California Department of Education sources. Following is a list of key data:

- California Basic Education Data System (CBEDS): We calculated administrative staff-to-student ratios based on data reported in 2004–05 by school districts.
- Form J-90: We calculated total compensation (salary and benefits) based on salary and benefit schedule data reported voluntarily by school districts.
- Annual Financial and Budget Reports: We used reports from 2002–03 to 2004–05 by school districts to calculate total revenues, total expenditures, and total reserves.
- CalWorks: We gathered data on the proportion of students, by district, eligible to receive free and reduced-priced meals from this dataset.
- P-2 K–12 Revenue Limit: We used ADA and revenue limit funding per ADA from 2002–03 to 2004–05 from this dataset.
- AB 1200 Status: We used published lists of districts by AB 1200 classification (positive, qualified, or negative certification) from 2002–03 to 2004–05.

### ***Research methodology and analysis***

This study relied on multiple quantitative and qualitative methods to analyze the available data, using multiple data points and analysis methods whenever possible to triangulate to findings. The study database includes both survey responses and state data. In addition to these variables, we developed an index that enabled us to categorize districts based on their fiscal health, using three categories: healthy, marginal, and unhealthy. We

were able to do this for both our sample districts and virtually all of the districts in the state.<sup>7</sup> That enabled us to analyze a variety of factors against districts' fiscal health. A fuller explanation of the fiscal health measure is included below.

Our analysis of results included descriptive statistics (survey summary) as well as various comparative statistics (ANOVA, Chi-squared, and regression analysis) used to test for relationships—or the lack thereof—between our three fiscal health categories, the survey responses, and state data as appropriate. In the Findings and Results section of this report we discuss variables for which there was a statistically significant difference based on the fiscal health of the district. Appendix X provides the technical output from the tests conducted within each finding area.

## The fiscal health of school districts

One of the central questions in the study was the relationship between a district's fiscal health and various factors, including those for which we surveyed and some available through state data. To answer this question effectively, we developed a measure of district fiscal health. Our approach and the measure itself are described below.

### ***The state's current measures identify few districts of concern***

Some work has been done outside California to create robust systems to evaluate school district financial conditions. For example, the Financial Condition Indicator System developed in 2003 to assess New York school districts looked at districts' short-run financial solvency, long-run financial condition, conditions within the local economy surrounding districts, and student performance as a measure of service-level adequacy.

These types of indicators are largely not available for California. Currently, the state uses a few simple measures to identify districts that are in poor fiscal health. These are fundamentally measures of district's short-run financial condition and solvency. A primary method is a process we refer to as AB 1200 certification. There are three levels of certification:

- Positive—any district that based upon current projections *will be able* to meet its financial obligations for the current and immediate two fiscal years receives a positive certification.
- Qualified—any district that based upon current projections *may not be able* to meet its financial obligations for the current and immediate two fiscal years receives a qualified certification.
- Negative—any school district that based upon current projections *will not* meet its financial obligations for the current or next fiscal year receives a negative certification.

In addition, districts are required to hire an independent firm to annually conduct a financial audit.

The AB 1200 process then is a straightforward evaluation of district solvency based on financial documents required by the state and dependent on local officials' ability to

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<sup>7</sup> The necessary data were unavailable for 12 school districts.

accurately project enrollments, costs, and revenues over time. When districts submit their annual budgets and interim financial reports to the county superintendent, they certify as to their ability to meet their financial obligations for the current and subsequent two years. County office officials in turn review these documents to validate the district's self certification. A similar process occurs when the district finalizes a collective bargaining agreement with employees. Of importance to this process are the state's requirements that all districts use a standardized account code structure for tracking revenues and expenditures; that they maintain a fund-accounting system that meets specific guidelines; and that they comply with state law regarding budget development, review, and submission. These rules are—in spirit if not always in practice—consistent with the guidelines of Governmental Accounting Standards Board (GASB) Statement 34, issued by the federal government in June 1999.

For this study, an obvious approach to creating a fiscal health indicator was to simply use this AB 1200 status to identify districts as healthy/marginal/unhealthy. We initially did this, defining healthy as all districts that received only positive certification from 2002-03 to 2004-05; marginal as districts that received one qualified certification; and unhealthy as any district that received a negative certification or two qualified certifications during the timeframe.

As the table below illustrates, the vast majority of districts fell into the healthy category by this measure, and the number of districts in the marginal category was particularly small. This was true not only for the state as a whole, but also for our sample. In addition, the data make clear the relatively small number of districts that have been identified as having fiscal difficulties under the AB 1200 process.

**Table 4. Fiscal health category based on AB 1200 certification from 2002–03 to 2004–05**

	Districts Statewide		Districts in Study Sample	
	Frequency	Percent	Frequency	Percent
Healthy	859	88.1%	106	78.5%
Marginal	69	7.1%	17	12.6%
Unhealthy	47	4.8%	12	8.9%
Total	975	100.0%	135	100.0%

However, recent experiences in California suggest that the current system underidentifies districts that may be facing fiscal health problems, and we saw this in the data as well. In particular, it does not provide a clear distinction between districts that are healthy and those that are marginal (at risk for problems given current practice). Specific issues include the following:

- **Management flaws compromise data.** There are several examples of school districts that received a positive certification under AB 1200 one year and then required the drastic step of state loans the next in order to meet their obligations. The fiscal crisis did not erupt in one year but went undetected for several years because of the lack of quality information about the true fiscal situation.

- ***There is limited ability to generate early warning.*** Under the current system, there are ways to distinguish districts that will clearly be unable to meet their financial obligations in the current year. However, there is no systematic review used to monitor or identify risky financial practices—such as deficit spending or inaccurate revenue estimates—that can eventually lead to fiscal problems.
- ***Districts and county offices have particular difficulty evaluating the long-term effects of their decisions.*** State law calls for districts and county offices to certify that the district can meet its obligations for the current year as well as the subsequent two years. There is no objective standard for these projections, however, and they are particularly difficult to evaluate or monitor due in part to dramatic funding fluctuations in the state budget and thus in school funding.

### ***This study's more robust approach showed more marginal and unhealthy districts***

For this study, we decided to develop a multidimensional measure that would consider not only districts' AB 1200 status over a three-year period, but also other financial trends. While there are a number of types of data against which to measure fiscal health, our goal was to create a fiscal health variable that was relatively simple and corresponded to factors identified in professional and academic research as good indicators of financial stability.

In selecting a formula for rating fiscal health, we focused on evidence of fiscal solvency. We were also mindful of the fact that the period for which data was being analyzed, 2002–03 to 2004–05, includes several fiscally challenging years due to cuts in state funding for education. For this reason, after evaluating a number of variables including deficit spending, revenues per pupil, and reserve levels, we selected a multistep approach that took into consideration districts' deficit spending patterns and reserve levels in addition to their AB 1200 status.

The basic premise behind the formula is that fiscally healthy districts are less likely to exhibit patterns of spending beyond their means and more likely to have reserves on hand. We calculated two indices: one based on a measure of the degree that deficit spending may be an issue (see Figure D); and a second based on the average level of reserves per student (ADA) from 2002–03 to 2004–05 (see Figure E).<sup>8</sup> Using both indices was important because during the period of time being reviewed many districts in California were forced to deficit spend due to unanticipated cuts to the state budget. However, some districts were better prepared or in a better financial position to do so because they had healthy reserves on hand. Hence, the two measures allow us to consider fiscal health based on level of current financial stability (structural deficits) and ability to withstand fluctuations in revenues from the state (measures of reserves). By using the two measures, we avoided automatically classifying a district that was deficit spending as fiscally unhealthy when in some cases that deficit spending was a prudent decision based on the availability of reserves set aside for just such an emergency.

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<sup>8</sup> Required reserve is based on statutory requirements. (Note that in 2002–03 and 2003–04 minimum reserve levels were reduced by 50%; and statutory minimum depends on the size of the district.) Calculated reserves apply only to unrestricted general fund revenues.



**Figure D. Index to measure deficit spending**

$$\frac{(\text{TotalRev}_{02-03 \text{ to } 04-05} - \text{TotalExp}_{02-03 \text{ to } 04-05})}{\text{TotalReserves}_{02-03 \text{ to } 04-05}}$$

**Figure E. Index to measure average level of reserves per ADA**

$$\frac{(\text{Required Reserve}_{\text{yr}} - \text{Actual Reserve}_{\text{yr}})}{\text{ADA}_{\text{yr}}}$$

We then ranked all districts in the state by the results of each index and divided them into three categories or levels—the top 70% of districts were labeled as “healthy,” the next 20% were defined as “marginal,” and the lowest 10% were considered “unhealthy.” These cut points were selected after reviewing the ranked list of districts. School Services relied on feedback from FCMAT and professional experience with districts to determine logical cutoff points for each classification. For cases in which a district fell into different categories based on the two indices, the lower category was selected. In other words, if a district was in the top 50% on one index, but in the bottom 10% for the other index, it was categorized as “unhealthy.”

The final consideration for the categorization was AB 1200 status, for which we used the same designations described above. Any district that had two qualified or one negative certification between 2002–03 and 2004–05—regardless of their level based on the other two indices—was automatically classified as “unhealthy.” Any district that received one qualified certification during this period was classified as “marginal.”

Once all districts statewide were classified into one of our three fiscal health categories, experts from School Services and FCMAT reviewed the distribution to validate the accuracy of the classifications. We then used these statewide results and cut points to classify the districts in the study sample.

The table below shows a breakdown of the results for both the sample and the state as a whole.

**Table 5. Fiscal health categories based on study's 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	1.2%		
Healthy	520	52.9%	53	39.3%
Marginal	275	28.0%	46	34.1%
Unhealthy	176	17.9%	36	26.7%
Total	983	100.0%	135	100.1%

Columns may not add to 100% due to rounding.

For the state as a whole, more than half of the districts were identified as healthy. Consistent with our expectations, our sample had a lower percentage of healthy districts as a result of the over-representation of districts that had received negative or qualified certifications. The distribution of districts in our sample, with larger numbers of marginal and unhealthy districts, gave us sufficient numbers to be able to do the kinds of comparisons against fiscal health that we envisioned.

#### A note about this analysis and the characteristics of unhealthy districts

To help understand our findings related to fiscal condition, it is important to note that the fiscal health index we used to divide districts was based on their financial records between 2002–03 and 2004–05. The survey of CBOs regarding district financial practices and experience of CBOs was completed in spring 2006. Hence, the survey responses are likely to reflect any changes in practice that the districts have implemented recently, perhaps after having been identified as having a fiscal health problem under AB 1200. While changes may be minimal for our healthy and marginal districts, it is possible that the unhealthy districts have experienced some type of intervention from either their county office or FCMAT. As a result, they may have changed their practices recently. Such changes would not have been in place during the time period we used for determining fiscal health, but they could show up in the survey responses.

## Findings and Results

### **Circumstances over which districts have limited control**

Numerous factors influence a school district's financial condition. Some are under the direct control of district management or can be significantly influenced by management decisions. Other factors are largely outside the sphere of influence of district management. This section examines the effects of factors that shape the environment in which a school district in California must conduct its financial affairs, including enrollment trends, district classification (i.e., elementary, unified, or high school), and revenue levels.

#### ***Enrollment trends***

School districts in California have limited control over their enrollment. They must serve all of the students who show up for class, but they can see the number of students grow or decline because of larger demographic and residential patterns in the state. Things districts can control—such as attracting students to good district schools on one hand and losing them to other districts or charter schools on the other—typically have only a marginal impact on total enrollment.<sup>9</sup>

Regardless, enrollment and attendance numbers have a substantial influence over school district expenditures and revenues in California. Enrollment establishes the number of teaching and support staff a district will be required to employ. But attendance rates among those enrolled students largely determine the amount of revenue a district will receive. Enrollment growth and decline also affect a district's capital facility needs and costs.

Declining enrollment puts specific fiscal stresses on school districts in California because of the funding system, while increasing enrollments bring financial advantages to districts. As school districts increase in enrollment, the state provides them with additional funds based on their per-pupil revenue limit. This amount represents an *average* amount that would be needed to accommodate the new workload, even though the district may not incur the equivalent increase in average costs for that unit of ADA. Instead, districts usually incur a *marginal* increase in costs for each additional student. Marginal costs would be the added salary and benefit costs for a teacher and an aide (if applicable).

Conversely, when enrollment declines school districts lose revenue limit funds at the *average* rate per ADA, rather than at a *marginal* rate. This loss of revenues must be accommodated by cutting costs beyond the classroom. A somewhat simplified example illustrates the point. If a district lost 30 ADA at a per-pupil revenue limit of \$5,000, it would face a loss in unrestricted revenue alone of \$150,000. However, cutting one teacher from the district's payroll would only reduce costs by about \$50,000 to \$60,000 (assuming the least senior staff would be released first). The savings related to an aide could be \$30,000. After making these reductions, the district would still have to find savings of at least \$60,000 to

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<sup>9</sup> It appears that for at least one large urban district in California (not in our sample), charter schools may be having a more substantial impact on district enrollments.

mitigate the revenue loss. Reductions in other school or district operations—such as administration, student support services, or maintenance—would be required to keep the district’s budget in balance. Because the scale of these operations do not adjust automatically with marginal changes in ADA, incremental implementation of reductions in these areas can be a major challenge. It should also be noted that this example assumes that the 30 students would all be in one school and that categorical funding would not be reduced, neither of which would likely be the case.

### Statewide, declining enrollment districts are more likely to be fiscally unhealthy

This section examines the relationship between enrollment changes and a district’s fiscal health among all school districts in California, both in the relatively short run.<sup>10</sup> For this purpose, we did a straightforward calculation of school district enrollment (based on ADA) histories from 2002–03 to 2004–05. The fiscal health status determination used data from the same period. Districts were categorized as either having declining or increasing enrollment during this period.

The table below summarizes the distribution of all districts statewide with regard to enrollment change and fiscal health. Statewide, districts that experienced declining enrollment are underrepresented in the healthy category and overrepresented in the unhealthy group. Conversely, districts that experienced increased enrollment are disproportionately healthy and less likely to be unhealthy.

**Table 6. Enrollment change and its relationship to fiscal health for districts statewide (2002–03 to 2004–05)**

Change from 2002-03 to 2004-05	Percent of Districts			
	Healthy	Marginal	Unhealthy	Total
Districts that Declined	48.7%	30.1%	21.2%	100.0%
Districts that Increased	55.8%	27.9%	16.3%	100.0%
All Districts Statewide	52.2%	29.0%	18.8%	100.0%

A further analysis of this statewide information used a regression analysis in order to control for other variables and isolate the effect of declining enrollment alone. This analysis corroborated that these statewide differences in enrollment were correlated with fiscal health and at a statistically significant level. (A similar analysis for our sample districts only produced some confounding results that are explained in Appendix IX.)

This analysis also examined a number of other district characteristics by type of district (elementary, unified, and high school), including district size, percent of English learners, and percent of students eligible for free/reduced-priced meals (a measure of poverty). For districts statewide, these characteristics showed no statistically significant correlation with our district fiscal health measure.

<sup>10</sup> This examination does not take into consideration economies of scale or the long-run effects of enrollment growth, decline, or instability.

It is important to note that the period for which we have enrollment data—2002–03 to 2004–05—does not capture the magnitude of enrollment declines that have occurred in California since. While some districts have experienced declines over several years, an increasing number are now facing this situation; and for many, the declines are becoming more acute.

Our survey asked respondents to indicate what they expect their district’s enrollment pattern to be for the upcoming three years. Slightly more than half of the respondents (51.5%) indicated that they expected their district’s enrollment to decline, 16.4% expected no change, and the remaining 32.1% expected an increase.

Table 7 examines these survey responses broken down based on our measure of districts’ fiscal health, placing districts in the healthy, marginal, and unhealthy categories.

**Table 7. Survey responses regarding expected enrollment changes over the next three years, analyzed against district fiscal health**

Reported District Expectations	Percent of Districts		
	Healthy	Marginal	Unhealthy
Enrollment Decline	46.2%	52.2%	58.3%
Enrollment Increase	38.5%	34.8%	19.4%
No Change	15.4%	13.0%	22.2%
Total	100.0%	100.1%	99.9%

Columns may not add to 100% due to rounding.

The data show that the expectation for enrollment declines is highest in the districts that are currently designated as fiscally unhealthy, as almost six in 10 anticipate enrollment losses. Less than one in five unhealthy districts anticipate an increase in enrollment over the next three years. On the other hand, more than half of the currently healthy districts expect either an increase (38.5%) or no change (15.4%), while 46.2% of this group expects to face enrollment losses. Of the districts identified as marginal, 52.2% expect to face declining enrollment over the period.

### ***District characteristics related to revenue levels***

An examination of the relationship between revenue levels in California districts and their fiscal health is confounded by several variables within the funding system tied to district characteristics. First, the amount of unrestricted revenue is under state control but depends in part on a district’s type and size. Other revenues, which can vary dramatically between districts, are determined by a combination of factors including the type of students served, special programs for which a district qualifies, and a district’s ability to generate additional local miscellaneous funds. We conducted a variety of analyses in an effort to examine district fiscal health as it relates to these revenue characteristics.

### **Statewide, unified districts are less likely to be fiscally healthy**

The fiscal health index we developed for this study made possible an examination of how different types of districts fare in regard to fiscal health. The state’s legal division of school districts into three types — elementary, high school, and unified — was a natural place to start and one that revealed substantial differences as the table here shows. The data suggest that both elementary and high school districts are more likely to be healthy and less likely to be marginal or unhealthy than unified districts.

**Table 8. District type and its relationship to fiscal health for districts statewide**

	<b>Healthy (n = 520)</b>	<b>Marginal (n=275)</b>	<b>Unhealthy (n=176)</b>	<b>No rating (n=4)</b>
Elementary School Districts (n=558)	61.5%	23.7%	14.7%	(n=1)
High School Districts (n=84)	53.6%	27.4%	17.9%	(n=1)
Unified Districts (n=333)	39.6%	36.0%	23.7%	(n=2)
<b>All (n=975)</b>	<b>53.3%</b>	<b>28.2%</b>	<b>18.1%</b>	<b>0.4%</b>

While these data are compelling, a number of factors make it difficult to draw substantive conclusions regarding the relationship between district type and district health. For example, revenue limits per ADA—and thus total funding per ADA—correlate highly with district type. By design, the state’s revenue limit system provides on average a higher per pupil amount to high school districts, a lower amount to elementary districts, and a middle amount to unified districts. District size is a similar variable, with elementary districts being the largest in number but the smallest in size. By contrast, unified districts include all of the state’s largest districts.

We then completed a further analysis in order to control for these other district variables. This regression analysis showed the same results and that they were statistically significant. Unified districts are more likely to fall into the marginal and unhealthy categories.

### Statewide, higher-revenue districts are more likely to be fiscally healthy

We also examined the extent to which districts’ fiscal health might be related to revenue levels. We examined their revenue limit (unrestricted) funds, as well as their total revenues, using a per-ADA measure to control for the size of districts. For this analysis, we looked at elementary, unified, and high school districts separately. We did not find any statistically significant relationship for high school districts, of which there are only 84 in the state. For elementary and unified districts, however, various analyses yielded a number of statistically significant results:

- Among elementary districts and among unified districts, those with higher total revenues per pupil (ADA) are less likely to be in the marginal or unhealthy category.
- Looking only at revenue limit amounts per ADA, the same relationships are true, with districts that have higher revenue limit amounts more likely to be in the healthy category.
- An examination of “other revenues” (total revenues minus revenue limits) shows the same general pattern, but not as strongly.

We also examined the relationship between district size and fiscal health using a regression analysis. We found that for the most part, district size alone does not seem to have a clear relationship to fiscal health. We did find one exception to this: large elementary districts are more likely to be marginal than healthy.

### A discussion of the revenue findings

Our findings show that, overall, the level of per-pupil revenue limit funding a district receives is more strongly associated with fiscal health than are other resources. However, there are two possible causes for this: (1) revenue limit funds are unrestricted, while the bulk of other funds are either state or federal categoricals earmarked for specific purposes; or (2) districts that get more “other resources” also have other characteristics (e.g., high poverty and thus Title I funds) that make their operations more complicated. Multiple and sometimes conflicting categorical programs could, for example, be making overall management more difficult and financial mistakes more likely. It is possible that it is this complexity, and not the level of funds available, that makes “other resources” look like they are less effective than the unrestricted funds.

These findings show that resources, and revenue limit resources in particular, are strongly related to fiscal health. While that relationship may be causal, it may alternatively be due to other factors associated with both fiscal health and the amount of funding a district receives.<sup>11</sup>

## **Personnel, practices, and policies related to district financial management**

The primary focus of a school business official’s responsibilities are a comprehensive understanding of California school finance laws and regulations, budgeting, cash management, financial planning, accounting, auditing, and financial reporting. Skilled business managers must also be competent in debt management, investments, and technology.

Well-run business offices prepare detailed demographic projections and associated enrollment-driven revenue projections. The office should also undertake regular evaluations of current year expenditures and recommend spending adjustments when necessary to keep the budget in balance. These reviews should cover both districtwide and school site budgets. The budget office should also provide the superintendent and board periodic updates of the district’s budget condition and present options to cope with budget imbalances. Effective policy decisions by the board depend on the clear communication of such fiscal information.

In addition to the skills and knowledge of the business professionals and the processes the staff follow, well-run districts constantly monitor key financial variables to assess district health.

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<sup>11</sup> The positive relationship between fiscal health and resources holds up when ADA, change in ADA, and percent English learners are added to the analysis. This gives support to the possibility that the relationship could be causal—but it is not solid proof.

This section explores critical questions across a broad range of categories, including:

- personnel issues, such as the stability of district leadership and the education and experience of district chief business officers;
- practices related to board governance and financial decision-making;
- practices related to district budgeting, accounting, and finance;
- practices related to facilities maintenance;
- compensation practices, including collective bargaining, salary increases, and retiree health benefits;
- the allocation of resources to school sites and practices related to site leaders' financial management;
- district effectiveness at maximizing resources.

These topics were all covered in the survey completed by CBOs in our sample districts. As appropriate, we examined their responses against the backdrop of districts' fiscal health based on the previously described indicator developed for this study. Along with summaries of the responses generally, this report emphasizes those analyses with fiscal health for which we found a statistically significant relationship.

### ***Personnel qualifications including stability, education, experience, and staffing***

The management of a school district's business functions can set expectations for the entire district. In well-run business offices, managers demand accountability, motivate staff, delegate authority where appropriate, and constantly assess processes and coordinate tasks to eliminate inefficiencies. Business office leaders also need to be responsive to unforeseen problems, understand both legal requirements and professional standards, and maintain a positive working relationship with all staff. All of this needs to be done within the context of the district's larger goals related to the educational enterprise.

Most CBOs in California have a broad scope of responsibility. Respondents to our survey were nearly unanimous in saying that they were responsible for their district's budgeting, accounting, purchasing, and risk management/insurance administration. Approximately seven out of 10 indicated responsibility for facilities, maintenance, operations, transportation, and food service. Only about half, however, said they handled their district's information technology, and about 15% said they had human resources responsibility for both certificated and classified staff.

Presumably, appropriate education and training are an important part of preparing school district CBOs for this demanding and complex work, particularly absent any mandatory or voluntary certification procedure in California. In addition, we have observed that districts with stable district leadership—especially of the superintendent and chief business official—generally seem to be more effectively managed. We also explored the opposite relationship: Is a lack of experience, inappropriate educational background, insufficient training, or high turnover at the top found more often in districts that are not fiscally healthy?

Within this study, we developed information about the qualifications and tenure of school district leaders from both available data and the survey questions. Related to this



leadership question, we also examined administrative staffing levels on the theory that part of a leader's capacity involves having sufficient staff to carry out the work at hand.

### Statewide, healthy districts are more likely to have stable superintendents

The state does not systematically collect data regarding the training, credentials, tenure, and experience levels of California school district superintendents. But based on records maintained by EdSource, we were able to compile some information about one of these characteristics—the extent of turnover at the superintendent level.

The data cover the five-year period from 2001–02 to 2005–06 and count the number of superintendents each district had within that timeframe, including interim appointments if a district transitioned from one superintendent to another. Districts that have had three superintendents (not including an interim appointment) during this five-year period can be reasonably characterized as experiencing a high level of instability at the highest leadership level, a condition that many experts believe makes sound financial management difficult.

Statewide, the majority of districts show relative stability at the superintendency. Among the 965 districts for which data are available, 38.7% have had the same superintendent for the entire five-year period, and another 45.6% have had just one change in leadership. Our sample districts showed virtually the same pattern.

We then examined the relationship between superintendent tenure and our designation of school districts as financially healthy, marginal, and unhealthy. That analysis found that, statewide, districts with the highest stability in the superintendency were more likely to be healthy. While 42% of the healthy districts in the state had the same superintendent the entire period, only 24.7% of unhealthy districts did. It should be noted, however, that districts with high turnover were not necessarily more likely to be in the unhealthy category. Again, patterns for our sample districts were consistent with this.

### CBOs in our sample are generally well-educated

As is the case with superintendents, the state of California does not systematically collect data regarding the training, credentials, tenure, or experience levels of chief business officers in California school districts. To provide some perspective on the important question of who is running financial operations in school districts, our survey asked about these issues.

Among the 122 CBOs who responded to survey questions about their education, we found that they were generally well-educated. Just seven (or 5.7%) reported having attained a two-year associate's degree as their highest degree. On the other hand, 63.1% say they have one or more advanced degrees, including 16.4% who report having a doctoral degree (most often in education). Of the 57 CBOs who report having a master's degree, 38.2% of the degrees are in business, 25% in education, and 15.8% in public administration.

Among the respondents as a whole, three-quarters report that they hold a bachelor's or advanced degree in a field related to finance in some way. This includes 57% with a degree in business, 11.9% in public administration, and 8.1% in economics.

### The majority of CBOs report participating in some voluntary training

In addition to having a finance-oriented background, the majority of CBOs in our sample reported having participated in at least one of the four voluntary training programs that were available to them prior to the 2006–07 school year.

*CASBO Chief Business Official Certification Program.* The CASBO certification program is one of the longest-running and most comprehensive training programs in California. Participants are required to complete 30 semester units of classes at accredited colleges and universities (or professional organizations, as appropriate), including courses in accounting, information technology, human resource management, and specific school finance areas (such as attendance accounting and budget development). In addition, CASBO certification requires participants to complete an additional 40 hours of continuing education every five years to ensure renewal. Among the sample districts, 53.5% of respondents said they had participated in or completed this program.

*ACSA School Business Managers Academy.* The Association of California School Administrators business academy was designed to meet certain requirements of the California Commission on Teacher Credentialing (CCTC) Professional Clear Administrative Services Credential. The program is held on 10 weekends throughout the school year. Topics include: business services leadership and organization; budget preparation and control; school finance, accounting, and auditing; and other school business operations. Among the sample districts, 47.6% of respondents said they had participated in or completed this program.

*School Business Management Certificate Program.* This offering from the University of Southern California (Rossier School of Education) is a year-long program that requires attendance two weekends per month (10-hour sessions) to complete 26 units of coursework, plus a fieldwork analysis and presentation. It also provides a mentor for students. In 2005 the program began operating as a partnership with School Services of California. Among the sample districts, 22.8% of respondents said they had participated in or completed this program.

*FCMAT CBO Mentor Project.* Coordinated by FCMAT, the new CBO Mentor Project trained its first cohort of 20 CBOs during the 2004-05 school year. The CBO mentor Project—a collaboration between CASBO, School Services, CCSESA, and FCMAT—emphasizes long-term, hands-on training and guidance. Training takes place over one year and consists of eight day-and-a-half sessions and various projects outside class, along with the pairing of participants with an experienced CBO mentor. The mentors must meet various criteria, including a business-related degree and a minimum of 10 years experience as a school district CBO. Just 8.2% of our survey respondents had participated in or completed this new program.

A total of 93 respondents reported that they had completed one or more trainings, with 26 of them having participated in multiple programs. (See Table 9 for survey responses.)

**Table 9: CBO participation in voluntary training programs based on survey responses**

Program	Participated but Not Completed	Completed
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Chief Business Official Certification Program (CASBO)	9	52
School Business Management Certificate Program (USC)	4	17
Chief Business Official Mentor Project (FCMAT)	1	6
ACSA CBO Academy	4	45

Data: EdSource/SSCAL Survey 2006

### Neither education nor training were clearly related to fiscal health of sample districts

A common assumption is that the education and training of a CBO is likely to be predictive of the quality of a school district's financial management and thus of its fiscal health. That hypothesis was not substantiated in this study, which showed no consistent relationship between a district's fiscal health as we defined it and CBOs' reporting of their level of education, type of degree, or training.

### An experienced cadre of CBOs report relatively short tenure in districts

Stability of business leadership is difficult to measure in California as the state collects no data on either CBO experience levels or tenure in a particular position. Data from our survey sample provides some sense of what may be happening statewide. It indicates a relatively high turnover in any given district, but a relatively experienced cadre of people filling CBO jobs statewide. On average, our respondents had 4.7 years of tenure as a CBO in their district and 10.5 years of total experience in the role.

Among the 129 district officials who responded to this question, 27.9% say they have been in their current job for one year or less and 64.3% report a tenure of four years or less. Another 9.3% of respondents indicate that they have been in their current position for more than 10 years.

In terms of overall experience as a CBO, 43.1% report that they have more than 10 years of experience. Just 9.2% say they are in their first year as a CBO, and 31.5% report that they have four years or less of experience.

### Healthy districts are more likely to have had the same CBO for a decade or more

We analyzed the extent to which CBOs' tenure in their districts related to fiscal health. Healthy districts were more likely to have a CBO whose tenure in the district was greater than 10 years, and marginal and unhealthy districts were more likely to have a CBO whose tenure was 10 years or less. This finding was statistically significant.

However, respondents' total years of *experience* as a CBO (regardless of the district) failed to show any consistent relationship to fiscal health.

Respondents were further asked how many years they had worked in their current district, regardless of job title. Here as well, the more years the CBO had been in the district, the more likely that district was to fall into the healthy category on our fiscal health measure. However, these findings did not reach the level of statistical significance.

While these findings show that CBO tenure and fiscal health are correlated, we cannot infer causality. Are districts fiscally healthy because their business leadership is stable? Or is the leadership stable because the district is fiscally healthy?

### Districts that report more administrative staff tend to be healthier

We used data collected by the California Department of Education to compare the level of administrative staffing among 131 of our sample districts. Staffing data from 2004–05, combined with the number of pupils per district (based on ADA), was used to calculate each district’s ratio of students to administrative staff. The data included both district-level administrators and employees in the office/clerical category.<sup>12</sup> We found that 58% of districts had a ratio between 76 and 125 students per administrative staff member. (See Table 10 for additional detail.)

We also found that staffing levels correlated with fiscal health. Districts with staffing ratios less than 125:1 are more likely to be healthy. Conversely, districts with staffing ratios more than 125:1 are disproportionately marginal and unhealthy.

**Table 10: 2004-05 staffing ratios for sample districts compared by district fiscal health**

Average ADA/Staff	Healthy	Marginal	Unhealthy	Total
75:1 or fewer	21.6%	2.2%	11.4%	12.2%
76:1 to 125:1	56.9%	66.7%	48.6%	58.0%
126:1 to 175:1	19.6%	28.7%	28.6%	24.4%
176:1 or higher	2.0%	4.4%	11.4%	5.3%

Data: California Department of Education (CDE)

### ***Practices related to board governance and financial decision-making***

Along with their responsibility to understand the state and federal laws under which school districts operate and to maintain professional standards, CBOs play an important role in informing the decision-making of their school board and superintendent. Further, their ability to function effectively can be either helped or hindered by the quality of those decisions.

In California, school district governing boards have the ultimate responsibility for approving their district’s budget and for many ongoing financial decisions. To do this effectively, board members need to, at a minimum, have a clear and accurate understanding of the school finance system, accounting principles, district operations, and the role they should play in the district’s fiscal affairs. This study did not survey school board members regarding these issues, but instead included some questions regarding school board training, the quality of financial information they receive, the procedures the board has in place related to fiscal oversight, and the extent to which the board evaluates itself and the superintendent. We also asked about the extent to which the district as a whole aligned its expenditures with strategic goals and priorities.

<sup>12</sup> The administrative staff includes superintendents, associate/assistant superintendents, supervisors, directors, coordinators in district level general administration and program/subject area administrators (PAIF assignment codes 0100-0171, plus 0501 and 0199).

### A quarter of CBOs report that their board receives high quality training

The vast majority of the CBOs who responded to the survey reported that they believed that board members in their district received training on school district budgeting and finance, but only 26.1% of respondents characterized it as high quality. Further, 18% report that it is either of low quality or not available.

Almost three-quarters of respondents say their new board members receive an orientation that includes information about the roles and responsibilities of the board and superintendent, but only 38.6% consider that orientation to be of high quality. It is also notable that 19.7% of respondents say that either board members do not receive this kind of orientation or that they do not know whether board members do.

Asked in a related question whether the roles and responsibilities of the board and superintendent are clearly delineated, more than half of the respondents say that is always the case in their district and another 30.4% say it is often the case.

### Respondents report boards receive good quality financial information

When asked about the quality of financial information provided to their boards, CBOs generally gave themselves fairly high marks, but with some notable variations. According to our survey respondents, board members in our sample of districts routinely receive important financial information, including a concise summary of the district's budget proposals. On this question, 71% said the information was of high quality, while 24% said it was of average quality. Respondents also reported that the budget is accompanied by an analysis of district expenditure and revenue trends for multiple years, but only 57% characterized that as high quality.

Almost all districts also report good practices with respect to ongoing communication about budget issues. For example, CBOs were asked to report on the extent to which changes or concerns about the district's financial position are brought to the board's attention immediately. Nearly all said this was either always (82%) or often (15%) the case in their district. Responses were somewhat less positive on the question of whether the district's budget planning process and timeline are communicated to all stakeholders, with 59.0% saying that was always the case and 32.8% saying it occurred often.

### District policies are reportedly of high quality but not always promptly updated

An important aspect of district governance is the maintenance of clear policies and regulations, with regular updating in response to changes in state and federal law. That task is complicated enough within the state of California that the California School Boards Association (CSBA) provides a policy-updating service to its member districts.

Virtually all of the survey respondents report that their district has written policies, with 63.0% saying those policies are of high quality and another 32.6% saying they are of average quality. Responses were just slightly less positive regarding whether the district also has regulations to deal with procedural matters.

While respondents say their district's policies and regulations are generally of good quality, they are a bit less positive regarding their prompt updating. With respect to updating board policies to reflect changes in law, only 39.6% say they always do so, 42.5% say often, and 14.2% say sometimes. A similar question with regard to district regulations was even less positive.

The survey also asked if boards had established limits for how much various district staff could spend without approval, to which 73.2% of respondents say their board had limits of high or average quality. Almost one quarter of respondents, however, say their district does not do this well (8.3%) or has no limits (15.2%).

### Most school boards formally evaluate their superintendent's performance, but few evaluate their own

The majority of respondents say their board uses a formal process to evaluate the district superintendent, with 67.2% saying that was of high quality. However, approximately 10% say their board only occasionally or never completes such an evaluation.

A markedly smaller proportion said their board uses a formal self-evaluation process. In fact, formal evaluations of school board performance appear to be more the exception than the norm in our sample districts, with almost two-thirds reporting that their boards only occasionally or never conduct such evaluations.

### Some board procedures correlate with fiscal health

An examination of the relationship between the CBO responses and district fiscal health revealed that a few of the practices noted above correlate, at a statistically significant level, with a district's fiscal health as delineated by our three categories of healthy, marginal, and unhealthy.

Our analysis showed that respondents in fiscally healthy districts are more likely to report that:

- their board members receive a high quality orientation regarding the roles and responsibilities of the board and superintendent;
- their board has high quality procedures in place to limit staff spending without approval;
- their district has high quality written board policies;
- their district has high quality regulations in place, and further that the district always updates those regulations promptly to reflect changes in law and policy.

### Districts vary widely in reporting that financial decisions are tied to goals

The survey also asked CBOs to reflect on the extent to which their districts tied allocation decisions to district priorities and goals. While between 70% and 80% of the responses to most of these questions were in the affirmative, respondents were somewhat mixed in their responses. For example:

- 31.3% of the respondents say that their district follows a strategic plan to a great extent. Conversely, 29.8% said they do so a little, not at all, or do not know.

- 36.6% say they link their financial plan and budgets to priorities to a great extent, but 17.2% say that happens little, not at all, or they do not know.
- 41.8% say their district regularly adjusts its financial plans/budgets to improve its ability to meet its priorities, while 20.2% said they did so little, not at all, or do not know.
- On the subject of implementing new programs, 47.4% of respondents say their districts are to a great extent able to consider goals closely when choosing whether to implement a new program. And 17.3% say they could do so little, not at all, or do not know.

Two questions had somewhat less positive responses. Just 22.6% of respondents say their district has, to a great extent, established procedures for evaluating the financial impact of budget amendments on its ability to meet its priority goals and objectives. Fully a third of respondents (34.6%) say their district did so little or not at all, and 1.5% do not know. And only 22.7% say their district is able, to a great extent, to cut programs that do not further strategic goals, while 38.7% say they are not able to do so. Another 2.3% do not know.

**Fiscally healthy districts report more positively about two strategic practices**

It was on these latter two questions that we also saw a statistically significant difference in responses based on a district’s fiscal health. Respondents from healthy and marginal districts are more likely to report that, to a great extent, their district has procedures for evaluating the financial impact of budget amendments. Healthy districts are more likely to say they are able to cut programs that are not aligned with strategic goals.

<b>Have procedures to evaluate impact of budget amendments</b>			
	Healthy	Marginal	Unhealthy
To a great extent	23.1%	26.7%	16.9%
All other responses	76.9%	73.3%	83.3%
<b>Able to cut programs not aligned with strategic goals</b>			
	Healthy	Marginal	Unhealthy
To a great extent	36.6%	11.4%	19.4%
All other responses	64.4%	88.6%	80.6%

***Practices related to district budgeting, accounting, and finance***

A prime responsibility of virtually all school district CBOs is the oversight of district budgeting, accounting, and finance. At a minimum, these processes must meet legal requirements. Effective CBOs go further than that, satisfying professional standards and also taking advantage of opportunities for efficiency where appropriate.

**Almost all CBOs say they follow appropriate budgeting and financial control procedures**

The overwhelming majority of survey respondents report that their districts either always or often follow procedures necessary to accurately estimate revenues and expenditures. Similarly, they either completely or strongly agree that their district maintains appropriate financial controls. Some variations existed under the surface of that apparent unanimity and also related to a few specific questions worth noting.

### A substantial minority report their projections are not necessarily useful

Respondents were asked a series of questions regarding their approach to enrollment projections, including their use of statistical techniques and consideration of external factors, such as new housing developments. While six out of 10 say they always or often do these things, only 16.7% of respondents say their district is always able to accurately predict turning points in enrollment. And 30.3% of respondents say they are sometimes or rarely able to do so.

In California, another critical part of maintaining fiscal solvency is assuring that employees receive layoff notices by the legal deadline, which in the case of teachers comes several months before districts can be sure about the revenues they will receive or the students they will enroll. Districts can face serious financial repercussions if they commit to retaining staff and then have either revenues or enrollments come in lower than expected. Despite this, more than one-third of respondents say they do not always issue layoff notices to certificated staff in a timely manner when projections indicate it is necessary.

### Certain financial control practices set fiscally healthy districts apart

On questions related to maintaining financial control systems, once again the vast majority of respondents (ranging from 66.7% to 85.1%) completely agree that their financial staff:

- analyzes significant expenditure processes to ensure appropriate controls,
- analyzes significant contracts, financial negotiations, and major expenditure categories for unusual cost fluctuations, and
- has effective payroll processes that ensure appropriate reporting of information to employees and timely payment of taxes and payroll deductions.

An analysis of these questions against fiscal health shows that respondents from healthy districts are more likely to completely agree than are their counterparts in districts classified as marginal or unhealthy. These results are statistically significant for the first two practices as noted below.

<b>Analyzes significant expenditure processes to ensure controls</b>			
	Healthy	Marginal	Unhealthy
Completely agree	79.2%	73.9%	58.3%
All other responses	20.8%	26.1%	41.7%
<b>Analyzes contracts, negotiations, and expenditures for cost fluctuations</b>			
	Healthy	Marginal	Unhealthy
Completely agree	84.9%	78.3%	58.3%
All other responses	15.1%	21.7%	41.7%

Respondents are only slightly less emphatic regarding their district's maintenance of appropriate controls against internal accounting problems. On two questions related to this, about 60% of respondents completely agree. Those include:



- identifying internal control weaknesses using multiple sources, and
- assigning responsibility for resolving internal control weaknesses to appropriate staff.

Once again, an analysis of these questions against fiscal health shows that respondents from healthy districts are more likely to completely agree.

<b>Identifying internal control weaknesses</b>			
	Healthy	Marginal	Unhealthy
Completely agree	66.0%	60.9%	47.2%
All other responses	34.0%	39.1%	52.8%
<b>Assigning responsibility for internal control weaknesses appropriately</b>			
	Healthy	Marginal	Unhealthy
Completely agree	75.5%	55.6%	54.3%
All other responses	24.5%	44.4%	45.7%

### Responses regarding position control yield surprising result

The results from the questions above stand in sharp contrast to a different question related to both financial control and payroll issues: the extent to which a district maintains an effective position-control system that does not permit expenditures without a budgeted position. Just 40.3% of respondents completely agree that their district does so, while 45.5% say they somewhat agree. That leaves 14.2% of respondents who disagree either somewhat (9.7%) or completely (4.5%). Position control has been a practice of particular concern for state officials who have found that many districts that have received emergency assistance from the state did not have appropriate controls in place. State law also requires county offices to watch for position control problems when approving school district budgets or issuing negative and qualified certifications.

In an analysis of the financial control questions and their relationship to district fiscal health, the position control question stood out. Respondents from marginally healthy and unhealthy districts (48.9% and 41.7%, respectively) are more likely than healthy districts (32.1%) to report that their districts maintained effective position control systems. (For a discussion related to this finding, see the section describing the fiscal health indicator on page 44.)

### Debt management practices reportedly meet legal and professional standards

Like other institutions public and private, school districts may occasionally or regularly incur debt as part of their financial management strategy. This may take a form such as general obligation bonds to finance long term acquisitions and capital projects, or it may involve the purchase of financial instruments such as Certificates of Participation (COPs) that can be used to address short-term cash-flow problems. In contrast to many other states, California has historically allowed districts to sell bonds using either a competitive bid or negotiated sale process. In 2006 state policymakers put some restrictions on this, requiring that district governing boards specifically pass a resolution approving the method the district

selects. The board is now also required to make various public disclosures regarding their decision.

The survey asked a series of questions related to districts' debt management practices. It is reasonable to assume that the need to use debt, and thus these practices, might be less common among districts with strong fiscal health.

The vast majority of respondents—more than eight out of 10—completely agree that their districts comply with legal requirements and ensure timely payment of their obligations. However, districts vary significantly in whether they maintain written policies and procedures related to debt management. Slightly more than 64% agree either completely (31.5%) or somewhat (33.1%) that their districts do so. Asked more specifically if their district has a formal process for evaluating its debt capacity prior to issuing debt, the responses are much more positive, with 89.0% saying they agree either completely (64.6%) or somewhat (24.4%).

Interestingly, healthy districts are more likely than unhealthy districts (68.1% compared to 47.1%) to report that they have a formal process for evaluating debt capacity in place. Marginal districts are the most likely to say so, however, at a rate of 73.9%. These differences based on fiscal health are statistically significant.

### Respondents' purchasing practices meet legal requirements, but cost-cutting measures are less common

Every year in California school districts spend hundreds of millions of dollars purchasing materials and services of various types. Based on 2004–05 district reporting, the average school district spends about 5% of its operating budget, or \$382 per pupil, on books and supplies; and it spends another 9% of its budget, \$686 per pupil, for various services and other operating expenses.<sup>13</sup>

In the course of making these purchases, and doing so responsibly, districts must first and foremost adhere to legal requirements. The vast majority of respondents to our survey, eight to nine out of 10 depending on the question, report that their district always:

- observes bid limits and force labor account limitations as prescribed by law;
- maintains policies and procedures that clearly prohibit bid-splitting and other legal violations;
- maintains a separation of duties to avoid a single person being able to specify a need and award a bid; and
- assures that key staff and board members file conflict-of-interest statements.

The survey also asked districts the extent to which they engaged in purchasing practices intended to minimize costs. Their answers varied more in this regard. A total of 91.8% say their district either always (61.7%) or often (30.1%) participates in “piggyback bidding,” a cost-saving process by which multiple districts join together to avoid duplication of effort in the bid process and increase their purchasing power.

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<sup>13</sup> Ed-Data State Finance Report 2004–05, District Averages, [www.ed-data.k12.ca.us](http://www.ed-data.k12.ca.us). Accessed August 2006.

California school districts can access a number of resources to help facilitate piggyback bidding and other cost-effective purchasing practices. Their ability to do so has been greatly enhanced in recent years by the expansion of online resources and networks. (See Appendix VIII for a partial list of these.)

Districts are somewhat less likely to try to reduce costs through participation in a joint powers authority, with 75.7% of respondents saying they do so either always or often. JPAs are most commonly used for the purpose of purchasing employee healthcare benefits and other types of insurance. An even smaller proportion of respondents (64.1%) say their district has suppliers deliver directly to schools whenever possible, a practice that can alleviate warehousing costs.

None of these purchasing practices appear to differentiate fiscally healthy districts from those that are marginal or unhealthy. Further, only a third of respondents characterized “cost controls outside of personnel” as essential to their district’s fiscal health.

### Districts’ financial software meets basic requirements, but it is less likely to fulfill specialized district needs

The use of technology in school districts continues to expand, and business office staff are often challenged to keep pace with these developments. While all business office leaders do not have to be experts in technology, they are expected to keep current with developments in this field and continually assess the district’s technology requirements. While the requirements are similar in many ways to those of any type of business, districts also have specific considerations unique to the enterprise.

One important issue is the choice of a financial accounting system and software. In general, school districts have three options: they can develop their own systems; purchase from a third party vendor; or adopt the system used by their local county office. By using the financial accounting system of the local county office, the school district facilitates the county office’s fiscal oversight responsibilities because report generation, formatting, and data retrieval will be consistent and familiar.

About three-quarters of the respondents to our survey say they use county office software, and 28.9% say they use software from a third-party source. Just 5.9% say they have designed their own systems. (Some respondents checked multiple answers.)

The survey also asked CBOs about several functionalities related to their financial information and reporting systems. The vast majority either completely or somewhat agree that their financial accounting systems provide basic functionalities:

- 91.9% agree that their software components provide for efficient data entry.
- 82.7% agree that their software components provide for reconciliations between control accounts and subsidiary records (payables, payroll, etc.).

Answers were somewhat less positive in regard to two functionalities more specifically tailored to a school district’s needs:

- 57.5% agree that their software components provide for capital project tracking by and across fiscal years.

- 60.0% agree that the format for financial reports is easy for the board to understand and assists them in making decisions, but only 18.5% of respondents *completely* agree with this statement.

**Financially unhealthy districts are less likely to rate specialized functionality highly**

It is interesting to note that the latter two items also show statistically significant variations based on districts’ fiscal health, with unhealthy districts less likely to report complete agreement with either question.

<b>Software provides for capital project tracking</b>			
	Healthy	Marginal	Unhealthy
Completely agree	32.1%	37.8%	19.4%
All other responses	67.9%	62.2%	80.6%
<b>Format easy for board to understand</b>			
	Healthy	Marginal	Unhealthy
Completely agree	22.6%	19.6%	11.1%
All other responses	77.4%	80.4%	88.9%

***Practices related to facilities management***

Well-run school districts strive to meet student housing needs through new construction and modernization. Generally, the resources for doing so come from sources outside of the district’s operating funds, including developer fees, and local general obligation bond and state bond proceeds. An examination of the availability of funding from those sources, and their impact on a district’s fiscal health, could provide valuable insights but was outside the scope of this study.

The business office practices districts used to maintain existing facilities through effective custodial services and maintenance operations are more germane to this study. Inadequate controls on the quality, cost, and tracking of these facility needs can affect a district’s fiscal health because they can lead to unexpected and sometimes substantial expenditures when building systems such as plumbing, roofing, heating, and electrical suddenly fail. A district then either has to find funds to pay for repairs or force students and staff to function in buildings that are at best uncomfortable and at worst unsafe.

Our survey asked CBOs several questions regarding their district practices related to facilities maintenance.

**Facility maintenance practices receive tepid ratings from CBOs**

One group of questions related to the measures districts take to document expectations for high quality work and evaluate that work, including the use of written procedures. In contrast to many areas of this survey, where the bulk of respondents selected the most positive response, only about 20% of respondents reported that their practices were of high quality in the following areas:

- the maintenance and operations department regularly evaluating its programs;

- the district having written procedures for facilities management and expenditures, or for maintenance and custodial services;
- basing work assignments and performance appraisals for commonly repeated tasks on performance standards.

A second set of survey questions asked about processes related to prioritizing maintenance needs, completing project cost estimates, and using a computerized system to track work orders and inventory. On these questions, about a third of respondents said their practices were of high quality.

The responses to all of these questions followed a consistent pattern in relation to district fiscal health, with unhealthy districts less likely to report practices of high quality. However, these differences were not at a statistically significant level.

### ***Compensation issues***

Because personnel expenses constitute more than 85% of operating expenditures in the average school district in California<sup>14</sup>, the issues related to employee compensation can be central to a district's financial management and fiscal health.

This study looks at three areas related to compensation: collective bargaining procedures and relationships; salary increases and compensation practices; and retiree health benefits. The findings reflect both survey responses and state data as indicated.

### **Collective bargaining procedures and relationships are generally strong**

In California, school district collective bargaining affects virtually every personnel-related expense and thus has a tremendous impact on resource allocations. Collective bargaining is also reflective of the district's priorities. The emphasis placed on salaries and benefits for employees can affect morale, attitudes, and student achievement. The best performing districts find ways to manage both the fiscal aspects of negotiations and the human relations side of the equation.

We asked survey respondents various questions related to their preparation for collective bargaining, their bargaining team and its practices, and their relationships with their teachers' union specifically. As context, we also asked about the unions with which they bargained. The vast majority (88.9%) reported that they negotiate with the California Teachers Association (CTA) as their teachers' union. For classified employees, the bulk of districts in our sample (78.5%) report that they negotiate with the California School Employees Association (CSEA).

### **CBOs overwhelmingly report good quality preparation for bargaining**

Professional standards call for districts to prepare for collective bargaining by developing accurate estimates of both district revenues and the projected costs of the initial bargaining proposals. This is typically the responsibility of the CBO.

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<sup>14</sup> Ed-Data State Finance Report, District Averages 2004-05, [www.ed-data.k12.ca.us](http://www.ed-data.k12.ca.us), accessed August 2006. Operating expenditures exclude capital outlay, other outgo including transfers to other agencies and debt service, and transfers of indirect costs.

The vast majority of our survey respondents (nine out of 10) report that prior to commencing negotiations, their district prepares financial exhibits of average or high quality that include:

- cost estimates for the district proposal (and union proposal if possible); and
- estimates of new revenues, supported by enrollment projections and revenue limit worksheets.

Typically, school districts use a negotiating team to bargain on behalf of the board. As the agent of the board, the team must meet the requirements of California's Rodda Act. These requirements include bargaining in good faith, the making and receiving of proposals in good faith, and the authority to reach tentative agreement on individual articles and the entire contract at the appropriate time. Clear and systematic communication between the board and the bargaining team prior to negotiations is essential for this to occur. Our survey respondents report high compliance with these expectations, with the vast majority (nearly nine out of 10) reporting that prior to negotiations:

- the board receives high (68%) or average (26%) quality information and a recommendation from the superintendent prior to authorizing bargaining parameters; and
- that in turn the board provides the district with high (62%) to average quality (23%) parameters prior to the commencement of bargaining.

### Quality training and support for bargaining teams are reported slightly less often

The training of the district bargaining team is an important part of preparing for negotiations because members of the team usually come from personnel, business, or school-site backgrounds. Although these perspectives are valuable to the process, these roles do not generally provide a basic foundation for negotiations. The fundamental process is fairly complex, peppered with nuances and confusing to the uninitiated. Learning on the job can be a very poor option when so much is at stake for districts.

On the question of how well the bargaining team is trained in the process of collective bargaining, just 40.3% of respondents say the training is of high quality and another 37.2% say training is of average quality. Respondents are more positive about the extent to which bargaining teams have access to outside experts. The vast majority of respondents (84.7%) report that their teams have this access, with 65.6% describing it as high quality.

Respondents were also asked about the extent to which the board stays informed and involved during the course of negotiations. More than three quarters of respondents say that their bargaining team always or usually returns to the board for a different authorization if an agreement cannot be reached.

### Healthy districts are more likely to report high quality cost estimates and bargaining team training

An analysis of these collective bargaining practices based on district's fiscal health revealed two statistically significant relationships:

- While more than 90% of respondents say they prepare updated cost and/or revenue estimates prior to collective bargaining, there are notable differences in the reported quality of these estimates between fiscally healthy and unhealthy districts. For instance,

respondents from fiscally healthy (90.2%) and marginal districts (93.5%) reported having average to high quality cost estimates compared to unhealthy districts (80.6%). A similar trend was true in regard to revenue estimates.

- As noted above, training for bargaining teams was also commonly reported; but respondents' evaluation of the quality of the available training varied depending on district fiscal health. Approximately 80.0% of fiscally healthy and marginal districts reported having high or average quality training in place compared to 70.6% of unhealthy districts.

### Relationships with teachers' union are largely positive

Overall survey respondents report relatively positive relationships with their unions. Almost 84% report that they always (24%) or usually (60%) have positive relationships with the leaders of their primary teachers' union. This is further validated by approximately 80% reporting that they always (38%) or usually (46%) were able to resolve grievances amicably during the last year.

The survey also included several more specific questions regarding the district's most recent negotiations and interactions with its primary teachers' union, with the following responses:

- 75.0% say their last contract was settled without any labor actions.
- 43.2% say their union had not filed any grievances in the last year.
- 82.6% say their district had not received any charges of unfair labor practices or a breach of the collective bargaining agreement.

### Salary levels and compensation practices show little relationship to fiscal health

With the passage of AB 2756, county offices of education in California are expected to place extra scrutiny on districts that provide salary increases greater than the state's statutory cost-of-living adjustment (COLA). For this study, we used state financial data to determine the prevalence of this practice among the districts in our sample. It quickly became clear that the timeframe of such an inquiry can have a material effect on the findings.

As described more thoroughly in the background section, the period considered for this study—2002–03 to 2004–05—was a challenging fiscal time for schools. The state provided relatively small cost-of-living increases in 2002–03 and 2004–05, and in 2003–04 California actually rolled-back revenue limits, in effect creating a deficit.

It is common in California for negotiated salary increases to be tied to the state COLA. During this period, the cumulative COLA increase in state revenues for the average district was 4.1%. However, based on data reported to the state by our survey respondents, their districts' cumulative increases for salary and benefits averaged 7.2%. Interestingly, we found little difference between the negotiating outcomes for districts based on whether they were fiscally healthy or unhealthy. This may reflect the fact that while collective bargaining is a local responsibility, virtually all the districts in our sample (almost 90%) reported having an active relationship with the California Teachers Association. CTA organizes across the state and is effective at ensuring consistency at the bargaining table.

On our survey, respondents were asked directly if their last contract with their primary teachers' union included a salary increase greater than the state COLA. Just 20.2% replied in

the affirmative, a much different result than the findings noted above. An important difference is that these responses generally reflected the contract for the 2005–06 school year, at least to the extent that contracts had been signed prior to April 2006 when the surveys were completed.

Other important issues related to district compensation practices can also arise as part of the collective bargaining process. Some districts, for example, approach negotiations by looking not only at a potential salary increase, but also at the total cost of employee compensation. This includes automatic increases based on teacher experience and education and also takes into consideration other cost increases such as employee benefits. Two-thirds of respondents report that their district always negotiates total compensation, and another 18.2% say that is usually the case.

Another large and growing component of employee compensation is health and welfare benefits. For the past several years, this cost has increased by double-digit amounts. Districts have taken a number of steps to control benefit costs including regularly reviewing enrollment eligibility, limiting benefits to full-time employees, and placing caps on how the district will contribute to benefits. The latter can be particularly important for long-term cost controls. Asked whether their district has a hard cap on the per-employee cost of health and welfare benefits, however, just 59.5% of respondents answered yes.

Our analysis of compensation practices against district fiscal health revealed no statistically significant relationships between these reported compensation practices and our designation of districts as healthy, marginal, or unhealthy.

### Most districts report limited or no retiree health benefits

The state of California allows school districts to commit to whatever postretirement benefits they negotiate with their employees, and in some cases the resulting long-term obligations have been dramatic. (See the Background section for a thorough discussion of this issue.) Our survey asked CBOs several questions related to their district practices in regard to postretirement health benefits and their approach to dealing with them.

Of the 129 district officials who responded to this part of the survey, 78.3% indicate their district either does not offer postretirement health benefits or that the benefits ended at or before age 65. An additional nine districts, 7.0%, say the benefits terminate between age 66 and age 85. The remaining 19 districts, 14.7%, indicate that the benefits are offered for life.

### Districts that report having lifetime benefits are more likely to be unhealthy

It is important to note that of the 19 districts in our sample that offer lifetime benefits, only three are considered fiscally healthy. The remaining 16 districts are equally divided between the marginally healthy and unhealthy categories. There is a marked difference between the fiscal health of districts that offer lifetime benefits and those that either do not offer the benefit or offer it for a shorter time period.

To corroborate this finding from our sample, we also conducted an analysis of district practices statewide related to the duration of retiree health benefits provided. This analysis focused on districts that do not offer lifetime benefits to retirees compared to those that do.



As part of controlling for other factors, this analysis looked at unified and elementary districts separately. (With high school districts totaling 84, this group was too small to make any findings significant.)

This analysis repeated the findings from our sample, but only to a level of statistical significance for unified districts: those that have an endpoint to their retiree benefits are more likely to be healthy. There was not a significant difference among elementary districts.

### District vary in their readiness to meet new reporting requirements

The survey also asked CBOs about their district's progress in addressing new legal requirements related to the issue of retiree health benefits. New federal requirements under GASB 45 require that districts record any unfunded liability in their financial statements, beginning in 2006 for the largest districts. This disclosure will reveal a district's actual outstanding liabilities that previously may not have been fully understood. These higher liabilities can increase the district's borrowing costs if they prompt credit-rating agencies to downgrade a district's bond rating. As a result, districts are being encouraged to conduct an actuarial study to identify the total unfunded liability they face and develop a plan for addressing unfunded liabilities in future years. As the table below shows, only a third of our respondents report that their district has completed an actuarial study and just 15% have completed a plan.

**Table 11: Reported actions related to analysis of retiree health benefit obligation**

	<b>Yes</b>	<b>In Process</b>	<b>No</b>
Conducted Actuarial Study (n=124)	34.7%	38.7%	26.6%
Developed Plan (n=120)	15.0%	55.0%	30.0%

### ***Resource allocation and financial management at school sites***

Tracking how school districts use the resources they receive can be approached a variety of different ways. State data (Ed-Data) provide some averages:

- In 2004–05, 86% of school district operating expenditures were for personnel, including certificated and classified staff, and employee benefits. (Capital outlay, other outgo such as transfers to other agencies and debt service, and transfers of indirect costs are not included in this calculation.)
- In 2004–05 school district expenditures statewide were allocated as follows:
  - instruction (largely classroom teachers and aides, including Special Education) 62%
  - instruction-related services and pupil-support services (e.g. school principals, counselors, etc. Also includes transportation, health services, testing, etc.): 19%
  - general administration (largely district office functions): 5%
  - plant services (maintenance, utilities, and other facility costs): 10%
  - other (includes a variety of miscellaneous categories): 4%

Looking at district-level variations in these expenditures is outside the scope of this study. Instead, we examined the manner and process by which allocation decisions were made, with a particular focus on personnel resources as the largest portion of district expenditures and on school sites as the key operational units in a school district.

To that end, this study focuses on how districts vary in their site-level allocation policies and practices, including the financial management ability of site-level administrators. It also examines district procedures related to the locus of decision making for various types of staff allocations and for nonpersonnel expenditures, such as professional development, materials, and equipment. A related area of inquiry is the extent to which districts vary their personnel assignment decisions based on school characteristics.<sup>15</sup>

### Responses indicate a disconnect between expectations for site-level management and training provided

The survey asked school district CBOs about the extent to which their district clearly communicated to principals the scope of their financial authority. Among the 135 survey respondents, the vast majority reported that this occurred to either a great extent (48.9%) or good extent (37.1%).

Answers from the 135 respondents tended to be less positive regarding the training of school leaders to manage site-level finances, despite holding them accountable for doing so:

- 60.8% report that principals receive training on financial management and budgeting to either a good or great extent. However, a sizable portion (35.3%) say that principals either receive a little training or none at all.
- Respondents are considerably less likely to say that site-level budget and policy groups (e.g. school site councils) receive training for their financial responsibilities, with 39.7% saying this occurs to a good or great extent and 50.3% reporting that it happens little or not at all. Notably, 9.9% say they do not know the answer to this question.
- A large percentage of respondents (76.4%), however, report that their districts hold principals accountable for sound financial management and budgeting to a good or great extent.

### Site-level allocation policies reportedly emphasize district control

The survey also included some general questions regarding the district's approach to site-level financial management. For example, CBOs were asked to what extent site administrators are expected to link their financial decision-making to school and student performance goals. Among the 135 respondents, about three quarters say they are expected to do so to a great (36.8%) or good (39.1%) extent. Most of the remaining respondents say this occurs to a little extent.

Two questions address the relative relationships between site-level budget flexibility and the sufficiency of district controls over site decisions. The differences in practice are relatively clear. The first question asked the extent to which the district gives staffing and budget flexibility to its site leaders. About two-thirds of respondents say this occurs to a great or good extent in their districts, but with just 26.2% of respondents selecting the most positive response. Contrast that with answers to the other question: whether their district has sufficient controls to ensure that school sites adhere to districtwide policies and procedures.

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<sup>15</sup> Some respondents did not answer a portion of the questions in this area because they worked in single-school districts, making the questions not directly applicable.

The 135 respondents were much more likely to answer in the affirmative to this question, with 87.8% saying they do so to either a great extent (38.6%) or a good extent (49.2%).

**Fiscally healthy districts are more likely to emphasize site-level capacity, accountability, and flexibility**

An analysis of these site-level allocation practices revealed some statistically significant differences in response depending on districts’ fiscal health designation of healthy, marginal, or unhealthy:

- The extent to which school-site administrators receive training related to fiscal management and budgeting is reported to be significantly greater among respondents from healthy districts.

<b>Principals receive training</b>	<b>Healthy</b>	<b>Marginal</b>	<b>Unhealthy</b>
To a great extent	57.1%	28.6%	14.3%
All other responses	42.9%	71.4%	85.7%

- Fiscally healthy districts are more likely to expect their sites to link financial decision making to school and student performance outcomes.

<b>Sites link finances to outcomes</b>	<b>Healthy</b>	<b>Marginal</b>	<b>Unhealthy</b>
To a great extent	50.0%	37.0%	17.1%
All other responses	50.0%	63.0%	82.9%

- The districts that report providing site principals/administrators with staffing and budget flexibility to a great extent are significantly more likely to fall within the healthy category.

<b>Sites have flexibility</b>	<b>Healthy</b>	<b>Marginal</b>	<b>Unhealthy</b>
To a great extent	48.0%	17.1%	5.9%
All other responses	52.0%	82.9%	94.1%

**Reporting of district-to-site resource allocation practices shows little variation**

Another set of survey questions explored in greater detail the issue of how districts allocate resources to schools, first by asking respondents to indicate which of three choices came closest to describing how general purpose resources are allocated to the majority of school sites within their district.

Among the 131 CBOs who answered this question, 30 put their district at one of two extremes in terms of site-versus-district control of resource decisions:

- 8.4% of respondents say their district office gives the school a budget to work with for both personnel and nonpersonnel costs, and the site chooses how to spend those funds.
- 14.5% of respondents report that their district office determines the number of teachers, administrators, and support staff a school has and also determines the school’s spending for nonpersonnel items.

We found a statistically significant difference in these responses based on a district's fiscal health. Those respondents whose districts are unhealthy are more likely to say that the district determines both personnel and nonpersonnel expenditures (22.9%) and less likely to say that their schools choose how to spend funds in both categories (2.9%).

A substantial majority of respondents, 77.1%, took a middle ground on this question, agreeing with the following: "The district office determines the number of teachers, administrators, and support staff a school has and then gives the school a budget for nonpersonnel costs, and the site chooses how to spend those funds."

A further question probed district practices in more detail, asking about the extent of school-versus-district control of specific decisions about the allocation of teachers, site administrators, support, and classified staff as well as a variety of nonpersonnel resources. For those districts that had answered the above question at either extreme, their answers to this second set of questions was relatively consistent with their general approach.

We thus decided to examine this set of questions based only on the responses of the 101 CBOs who reported that their district struck the middle ground in terms of its allocation approach. The goal was to further illuminate what constitutes standard practice among the apparently typical districts in which the district makes personnel decisions and the sites control nonpersonnel budgets. For each of the items we asked about, respondents had a range of possible responses along a continuum: schools decide alone, schools decide within district guidelines, schools and districts share equally in decision, district decides with school input, and district decides alone (or based on formula).

### Districts decide the number of teachers; schools have more voice in which people and their assignments

Arguably the most important resource in a school is its teachers. The survey asked CBOs how decisions were made about the number of teachers assigned to a school and about the assignment of individual teachers both to a school and to specific teaching assignments within a school:

- The overwhelming majority of respondents (91.7%) say their district decides on the number of teachers at a school, but with a substantial portion (52 schools or 53.6%) saying that schools provide input. A small group, 7.2%, say that schools and districts share the decision equally, and just one respondent says that schools decide within district guidelines. (n=97 responses.)
- These respondents indicate that schools are much more likely to have a decision-making role regarding the specific teachers assigned to a site, with 25% saying schools decide either alone (1%) or within district guidelines (24%). Another 37% characterize this as a shared decision. That left about a third of respondents who say their district decides either with school input (30%) or alone/by a formula (6%). (n=100 responses.)
- When it comes to how individuals are assigned within a school, however, 69.7% of the respondents say that schools either decide alone (16.2%) or within district guidelines (53.5%). Another 16.2% report that the school and district share equally in the assignment decision. The remaining 13% say their districts decide either with school input or alone.

### Districts exercise considerable control over other staff assignments

Among the subset of the sample we looked at for this series of questions, respondents overwhelmingly report that their districts decide both the number and type of site administrators. Schools have only a bit more influence over the number and type of professional support staff. While still limited, schools appear to have slightly greater influence over classified staff decisions.

**Table 12. Respondents' characterization of site vs. district decisions regarding staff allocations**

<b>Resource Decision</b>	<b>Schools decide alone, based on district guidelines, or share equally in decision</b>	<b>District decides with school input</b>	<b>District decides alone (or based on formula)</b>
Number of Site Administrators (n=98)	6.1%	28.6%	65.3%
Type of Site Administrators (n=99)	8.1%	30.3%	61.6%
Number of Professional Support Staff (n=98)	9.1%	40.8%	49.0%
Type of Professional Support Staff (n=98)	20.4%	39.8%	38.8%
Number of Classified Staff (n=96)	11.5%	41.7%	45.8%
Type of Classified Staff (n=95)	22.1%	38.9%	37.9%

### Schools decide on supply purchases, but they have limited authority over other nonpersonnel expenditures

Additional questions looked at the balance of decision-making authority for a variety of nonpersonnel expenditures. The respondents in this subset varied substantially in how they described allocation practices that, based on their general answer, they had characterized as being the choice of school sites:

- Regarding professional development for teachers, the majority of respondents (58%) report that the district and schools share equally in the resource-allocation decision. Of the remainder, 24% say the district decides either with school input or alone, while 17% say that schools decide either within district guidelines or alone. (n=100.)
- Regarding decisions about capital equipment purchases (e.g., computers, copiers), about half of the respondents report that schools decide either within district guidelines (41%) or alone (7%). The remainder are nearly evenly divided between saying that schools and districts share the decision and that districts decide either with school input (18%) or alone (6%). (n=100.)
- It appears that the one area where schools have the greatest discretion is in the purchase of supplies. The vast majority of the respondents (84.7%) report that schools decide this either alone (31.6%) or within district guidelines (53.1%). That leaves 15.3% of respondents

saying that the district plays a role in this decision, though in most cases it is to share equally in it (9.2%). (n=98.)

- By contrast, textbooks and instructional materials are not a site-level decision among the majority of districts in question. About a third of respondents say schools decide either alone or within district guidelines. The balance of responses are split, with 28% saying schools and districts share the decision and 40% saying that districts decide either with school input or alone. (n=100.)
- Respondents are also clear that the district is the key decision-maker regarding staff and services related to facilities upkeep. Altogether, 80.8% say the district makes these decisions either with school input (39.4%) or alone (41.4%). Just 14.1% say that schools are equal partners in the decision, and 5% say that schools decide either alone or within district guidelines. (n=99.)

### Respondents report staff allocation decisions consider school and student characteristics

The survey asked CBOs a further question about how their districts decide on the number and type of personnel assigned to a given school site and the extent to which they consider a variety of site conditions in those decisions. Overall, respondents report that their districts give some consideration to school performance and to student characteristics—particularly the percentage of English learners—when they allocate personnel to sites:

- 31.3% of respondents say that their district strongly considers school-level performance on state tests when it decides on the number and type of personnel to assign to a school. Another large group (49.2%) say this is somewhat of a consideration.
- Responses are similar in regard to the extent that the district considers the percentage of low-income students when it allocates personnel to a site, with 27.0% saying it is strongly considered and 54.8% saying it is considered somewhat. That left almost 20% of respondents who either say it is not considered or that they do not know.
- The vast majority of respondents (94.5%) say their district considers a school's percentage of English learners either strongly (43.3%) or somewhat (51.2%).

Increasingly, criticism has been leveled at school districts that overload schools with inexperienced teachers, particularly when those schools serve the neediest students. Our survey attempted to learn the extent to which districts considered the experience of a school's teaching staff when it allocated personnel. A small group of respondents (18.9%) report that this is strongly considered, and another 48.8% say it is considered somewhat.

### ***Practices and effectiveness that are related to maximizing resources***

School districts in California have very limited options for increasing their revenues. Within that context, however, some districts report disproportionately high revenues in certain categories, particularly within the “local miscellaneous” revenue category.

On our survey, we asked CBOs to assess the extent to which they believed their district was effective in maximizing their revenues. These questions fall into several categories, including state and federal funds generally, interest income, private contributions, and revenues that are the result of more entrepreneurial efforts.

### Respondents generally report success in maximizing public funds

The survey asked CBOs to characterize how successful their district was at maximizing revenues from various public sources, including unrestricted state funds, state categoricals, and federal categoricals.

The unrestricted state funds category is largely revenue limit funds. The state sets the per-pupil allocation of these funds based on historical formulas. For the most part, districts can maximize these funds based on the number of students they enroll and their success at promoting high student attendance.

On average, school districts in California depend on categorical programs for about a third of their general fund revenues. Some categorical funds are automatically provided based on student characteristics. An EdSource analysis of categorical programs in 2003–04 estimated that about 32% of state categorical programs and 69% of federal programs were of this type.

Another 33% of state and 8% of federal categorical programs were for purposes related to instructional improvement. The bulk of these require that a district operate a specific program and often require that districts apply for funding.

The balance of both state and federal programs were typically for specific programs that only selected districts operate, including some outside of K–12 instruction (such as child care and adult education).

In general, respondents characterize their districts as either somewhat or very successful at maximizing revenues from public sources. But while about two-thirds (67.5%) say they are very successful at maximizing the unrestricted funds their district received, only about half express comparable confidence in regard to state and federal categorical funds.

### Respondents split regarding success at maximizing interest income

School districts in California often manage and hold large sums of money. Interest on these funds can be a helpful, if modest, source of revenue. On average in 2004–05 (Ed-Data), school districts earned \$32 per pupil (based on ADA) in interest income. Our survey respondents were somewhat pragmatic regarding their success at maximizing interest income, with only 33.3% saying they were very successful at doing so and the majority saying they were somewhat successful (58.1%).

### About half of respondents report success securing revenues from private sources

The survey asked CBOs how successful they felt their district was at maximizing private cash and in-kind contributions. Slightly more than half characterize their district as either very or somewhat successful at both; but a large portion, about 15%, either say they do not know or did not respond to this question.

School districts are required to report official contributions they receive from private sources, but there is some skepticism in the field about the rigor with which all districts do so. State financial data do not itemize these types of private contributions but instead include

them in a revenue category called “all other local revenue” (Object Code 8699) that covers other sources as well. Thus, there are no clear state data regarding how many districts receive private funds or what amount they receive.

In the survey, we asked respondents if their district received either funding or in-kind contributions from three different types of private sources: private foundations, local education funds or foundations, and local business partnerships. About three-quarters report that their district receives in-kind contributions from each of these sources. In regard to cash contributions, however, the answers are both less positive and more varied.

### Success rates and people responsible for private contributions vary depending on the funding source

Along with requesting an estimate of funds received, the survey asked CBOs to report on which group within their district “was most instrumental in generating this revenue.” They could choose district office/governing board, school site, and parents/community. These responses varied based on the type of private funding source.

*Private foundations.* Among respondents, 39.2% say their district receives funding from private foundations. The amounts reported vary from \$1,000 to \$8.2 million, with the median about \$30,000. The types of districts largely reflected the sample as a whole, except that they had slightly higher percentages of English learner students, with 55% of them above the median for the sample.

Of the CBOs who report that their district has received private foundation funding, about half say their district/governing board was most instrumental in securing the funds. This response is somewhat less common among smaller districts.

*Local education fund/foundation.* More than half the respondents (57.7%) say their district receives funding from local education funds/foundations. The reported amounts vary from \$5,000 to \$3.8 million, with the median about \$70,000. These districts appear to serve more privileged populations. They have markedly lower percentages of EL students than the sample as a whole, with 64.1% of them below the median for the sample and just 6.3% in the top quarter. The same general trend is true regarding these districts’ likelihood of having low-income students.

Of the CBOs who report that their district has received local education fund/foundation revenues, more than half say parents/community have been most instrumental in securing the funds. This is less likely to be the case in large districts, however, where the district/governing board is cited a bit more often than in smaller districts.

*Local business partnerships.* Fewer respondents (42.1%) report that their district receives funding from local business partnerships. The amounts vary from \$1,000 to \$2.5 million, with the median about \$25,000. These districts have somewhat lower percentages of EL students than the sample as a whole, with 57.1% of them below the median for the sample and 14.3% in the top quartile. The same general trend is true regarding these districts’ likelihood of having low-income students, though 19% are in the top quarter of the sample on this measure. These districts are also somewhat more likely to be large in size (35.7% with more than 20,000 students) compared to the sample as a whole (29.7%).



Of the CBOs who reported that their district had received funds from local business partnerships, slightly less than half say that the school site has been most instrumental in raising the revenues.

### Few CBOs report success maximizing revenues from property or services

Some California school districts are able to generate substantial revenues from either the property assets they hold or services that they provide to other groups, often other school districts. Less than 20% of our sample characterize their district as “very successful” at maximizing this type of revenue. In general, the districts that did report this level of success reflect the same characteristics as the sample as a whole, with one exception. They are somewhat more likely to be above the median in their percentage of low-income students.

*Lease and rental income.* On average in 2004-05 (Ed-Data), school districts earned \$19 per pupil (based on ADA) in lease and rental income (Object Code #8650). This includes leasing surplus district property to various groups as well as charging civic center fees. Because the latter are in theory only levied to cover the cost of allowing local groups temporary use of school facilities, the extent to which they bring districts a net financial benefit is certainly debatable.

The survey asked CBOs how successful they felt their district was at maximizing this type of revenue. Equal percentages say their district is very successful and either somewhat or completely unsuccessful. Among the 26 respondents who say “very successful,” the vast majority (84.6%) are in school districts with fewer than 20,000 students. Among the 26 respondents who say they are “somewhat or completely unsuccessful,” the distribution by district size is relatively even.

*Service income.* On average in 2004–05 (Ed-Data), school districts generated \$32 per pupil (based on ADA) in revenues from other districts for contract services (Object Code 8677), and an additional \$10 per pupil (based on ADA) that came from federal sources (Object Code 8285). These services may include such things as professional development, support for students, and transportation.

The survey asked CBOs how successful they felt their district was at maximizing this type of revenue. The responses echoed those for lease income exactly.

Although just a small portion of districts report being successful at raising private contributions, fiscally unhealthy districts are more likely than healthy districts to say they are very successful.

<b>Successful at maximizing revenues from private contributions</b>			
	Healthy	Marginal	Unhealthy
Very successful	13.0%	16.3%	21.9%
All other responses	87.0%	83.7%	78.1%

### CBO concerns regarding fiscal health and enrollment changes

We took advantage of the opportunity offered by this survey to ask CBOs about the threats they saw to fiscal health both in the recent past and in the future. They also responded

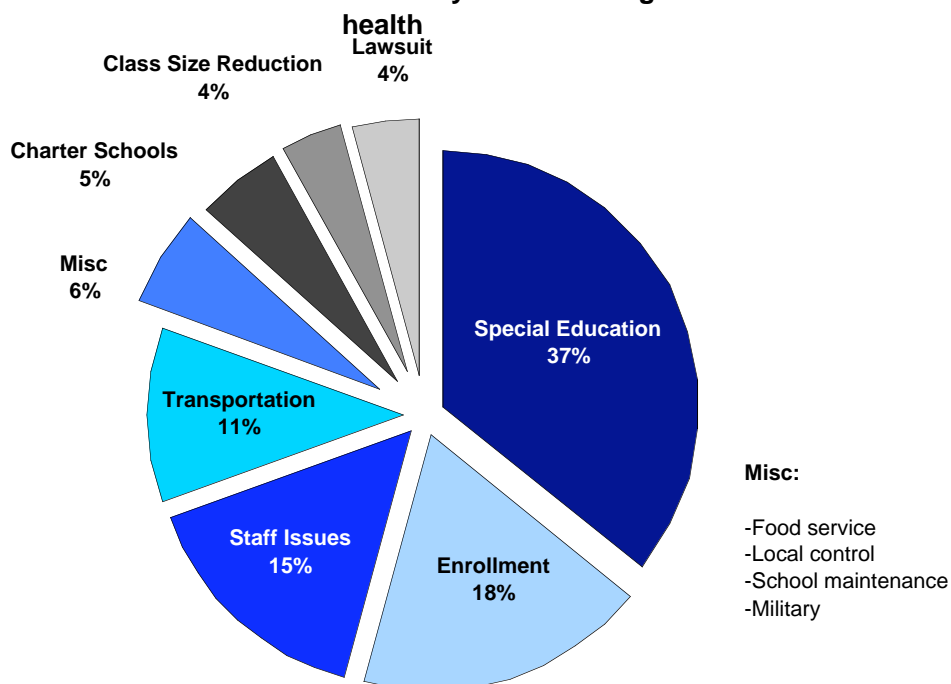
to a set of questions related to how their district planned to respond to expected enrollment changes.

***Districts look to the past and to the future to answer fiscal health questions***

**Reported threats to districts’ fiscal health focus on rising costs**

The first question asked respondents to look back and report on any circumstances that were unique to their district, outside of the district’s control, and threatened the district’s ability to remain in good fiscal health. We asked an open-ended question to this effect which 65 (or about half) of our respondents answered. Several mentioned two or more things, providing a total of 98 responses to this question. The pie chart indicates the general categories into which these responses fell.

**Figure F: Special circumstances outside of district control that CBOs reported had threatened district's ability to remain in good fiscal**



Note: 65 districts (48%) answered this question. Because some districts provided multiple answers, the total number of responses is 98.

EdSource 9/06

It is interesting to note that the majority of these responses dealt with issues related to increased expenditures:

- The most common response, Special Education, was often more specifically described as Special Education encroachment (the need for a district to contribute a greater than expected portion of its general operating funds to support a categorical program).
- Encroachment was also an issue mentioned in regard to transportation, a program for which the state provides some funding but based on historical funding formulas rather than on direct district expenses.

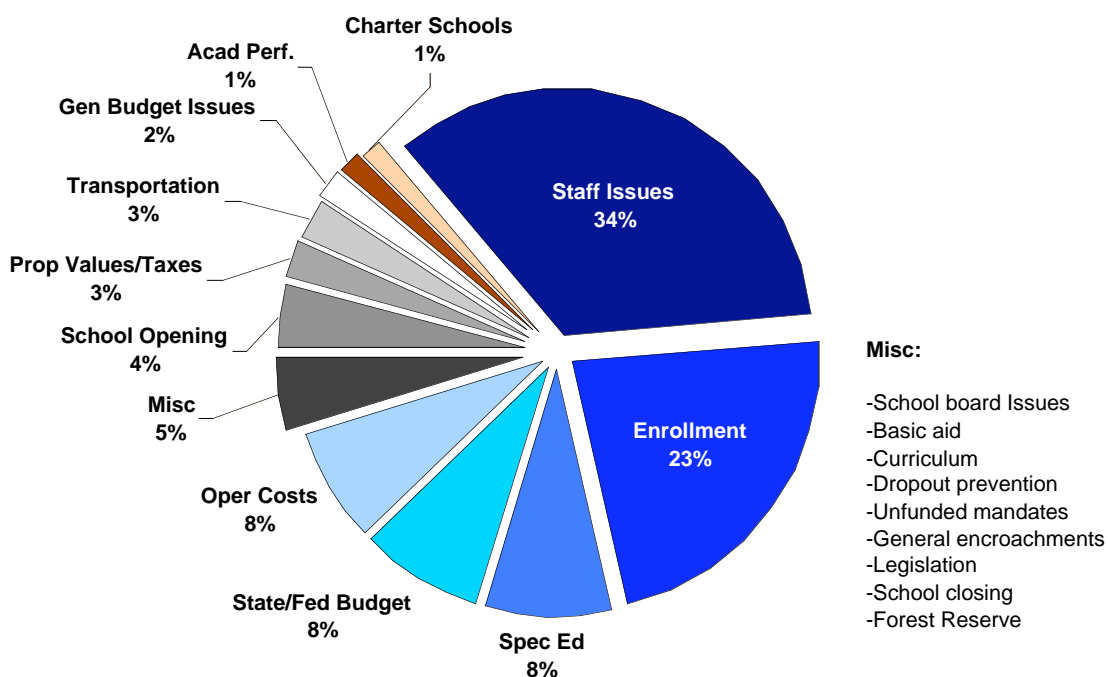
- Staff-related costs of various kinds were mentioned, most notably increases in medical benefits for current employees and retirees.

About one in five responses focused on reduced district revenues as a result of losing students. In most cases this was characterized as declining enrollment generally, but a few respondents specifically mentioned the impact that charter schools were having on their district’s enrollment numbers and thus on revenues. Through 2006, state law called for an immediate reduction in state funding when students transfer from a regular public school to a charter school. Senate Bill 1446 (2006) made changes in that process to lessen the impact on districts.

**CBOs expect current financial concerns to continue in the next three years**

When asked, “What do you believe are the most significant financial issues your district faces in the next three years?,” the most common responses were staffing issues, enrollment, Special Education, concerns over the state and federal budget, and various operational costs. A total of 112 respondents (82%) answered this open-ended question. Because some districts provided multiple answers, the total number of responses is 276.

**Figure G: The most significant financial issues CBOs reported that their districts face in the next three years**



Note: 112 districts (82%) answered this question. Because some districts provided multiple answers, the total number of responses is 276. Percents of total responses is shown.

EdSource 9/06

As with the previous question, staff compensation, enrollment, and Special Education all received strong mention. In addition, concerns about state and federal budgets emerged as a concern for CBOs going forward. Respondents cited the general uncertainty surrounding the state budget, primarily focused on projected 2007–08 cuts in school funding. Respondents

also expressed a lack of confidence in the state's fiscal housekeeping, citing concerns over structural deficits/imbalance, volatile funding variations, and funding misallocation.

Under the topic of staff compensation, while most respondents again cited expense issues such as benefits and salary increases, a small number said they were concerned about union negotiations and retirement of long-standing leadership staff.

### ***Strategies for coping with enrollment changes***

Enrollment changes occupied a prominent place for many respondents, with the focus almost entirely on declines. Elsewhere in the survey, respondents were asked what actions their district was considering to address both declining and increasing enrollment. As noted previously, the expectations regarding enrollment changes among our sample districts were as follows:

- 51.5% are planning for enrollment declines in the next three years,
- 33.1% are planning for increases, and
- 16.4% expect no change.

#### **District vary to some degree in reported plans for coping with enrollment declines**

Respondents were given a list of possible actions and instructed to check all that applied. All districts anticipating enrollment losses in the next three years indicated that they would consider staffing reductions:

- Virtually all districts will consider reductions in teaching staff.
- Nine in 10 districts will consider reductions in classified staff.
- Seven in 10 districts will consider reductions in administrative staff.

The survey further revealed that 42% of the districts anticipating a drop in enrollment are considering reconfiguring their existing schools to accommodate the smaller and different mix of students. As a last resort, districts look to closing schools if enrollment continues to fall, and slightly more than one in three respondents (34.8%) acknowledge that school closure is under consideration.

Closing a school is often a difficult decision for a school board because of almost inevitable public and staff resistance. But at a certain point such actions can become necessary in order to preserve the educational program for the remaining students. Faced with sufficient decline in enrollments, districts must cut their overhead costs and closing a school can accomplish that by reducing the district's facility, administration, and operating expenses.

In addition to the options specifically listed in the survey, respondents were asked to list other strategies under consideration to address problems created by declining enrollment. They mentioned the following:

- improve the rate of attendance to enrollment;
- build budget reserves;
- lease vacant facilities;
- offer programs to attract new students, such as state preschool;

- reduce operational purchases;
- pursue a parcel tax or renew the existing parcel tax; and
- offer early retirement incentives.

## **Discussion and implications**

### ***Regarding fiscal health***

This study attempted to develop a methodology to identify fiscally troubled districts that would probe deeper than the state’s official AB 1200/AB 2756 designations of positive, qualified, and negative certifications. In addition to these certifications, the methodology incorporated district expenditure patterns and reserve levels over three years to assist in identifying fiscally marginal and unhealthy districts. The metric we developed actively uses trend data, and it appears to identify a large group of districts that we have placed in the category of marginal fiscal health, meaning that they are at risk for serious financial trouble. This measure informed our study, and we believe it also suggests that implementation of the state’s fiscal accountability process could be improved.

To put it more strongly, it appears that some districts and county offices allow financial problems to go undiagnosed or unaddressed beyond the point at which effective intervention should occur. The reasons for this likely depend on the specific district or county office in question. Anecdotal evidence from FCMAT suggests at least one area within the existing AB 1200/2756 protocols that these agencies could particularly improve: multiyear projections. The current certification process requires districts to address not only the current budget year, but also the two years after a district budget is approved. FCMAT’s reviews have found these projections are sometimes not done thoroughly or particularly conscientiously.

However, districts’ ability to develop quality, comprehensive multiyear fiscal plans is hampered by a number of existing conditions and rules related in particular to personnel management. For example, legal restrictions on how districts lay off staff make financial planning difficult, as does the dynamic of collective bargaining. In addition, wide variations in state revenues have made this even more challenging in recent years. Between 2000 and 2006, the highest year provided more than 10% in new funding and the lowest included a 1.2% reduction in funds. In both cases, a district could not have predicted these changes when it adopted its prior-year budget.

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. 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.

### ***Financial management personnel, policies, and practices from the CBO’s perspective***

This study relies heavily on the knowledge and opinions of school district chief business officers (CBOs). CBOs in 135 districts (about 14% of the districts in the state) completed our survey and thus our research findings are shaped by their collective input. Based on our respondents' answers, we can conclude that virtually all of the school districts in our sample comply with the state's requirements for the collection and reporting of financial information. The CBOs also self-report that they generally adhere to the best practices of their profession. This relative unanimity to some degree limited our ability to draw clear relationships between the fiscal health of districts and their personnel qualifications, policies, and practices. Nevertheless, this analysis reveals many interesting results.

Our findings make it clear that it is easier for some California school districts to stay fiscally healthy than it is for others, and that is related to some degree to conditions largely outside of their control. The findings indicate that the relative amount of per-pupil funding a district receives is related to its fiscal health, with districts that have more resources more likely to be healthy. The same is true for districts experiencing increasing enrollment and thus an increasing amount of funding from one year to the next.

We would add that examples of districts that received emergency assistance from the state suggest that rapid or unexpected declines in student enrollment, and thus in funding, can be the tipping point for some districts that we would place in our "marginal" category. In recent years, changes in some districts have been sudden and very difficult to predict. Given that more than half of the districts reported an expected enrollment decline in the next three years, we believe this could represent an important and continuing problem for school districts statewide.

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.

### Leadership stability can have far-reaching impact

While this study was largely confined to practices under the control of the CBO, it also made it clear that both the quality of financial management and district fiscal health depend on more than the skills and commitment of the CBO. The practices of the district superintendent and school board have a relationship to a district's fiscal health. The scope of this study was limited in its exploration of this topic. We would recommend that further study of the financial training, stability, and fiscal practices of these district leaders be undertaken.

While we heard from CBOs that their financial management practices are to a great extent consistent with professional standards, our data indicate that stability at the top—both for the superintendent and the CBO—correlates with a district's fiscal health. We further believe that leadership stability provides an environment in which district goals and priorities can be consistent and clear, and in which some important professional practices can take root and flourish, including:

- Open and clear communication between the board and district staff, between the district office and the school sites, and between the district and the community.
- A clear delineation of the respective roles of the school board and district management.

- The ability to implement sound financial systems and make adjustments to those systems to reflect changing circumstances.
- The development of well-crafted policies on debt management, contracting, employee compensation, etc., with clear lines of fiscal accountability.
- Effective linkages between the financial planning process and the subsequent execution of the plan, with adjustments as necessary.
- Effective involvement of school site staff in the financial aspects of their operations, including linking resource allocation decisions to student performance.
- Expertise and consistency in the collective bargaining process, and the development of constructive relationships with union leaders.

### Opportunities for improvement are apparent

Our findings also suggest that there are some specific areas of financial management that districts should strengthen. Adequate staffing of administrative positions, for example, could help districts make sure their financial house is in order. 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. This is another area where further study might be appropriate to determine how school districts' practices could be strengthened.

The state has targeted resources at improving training opportunities for CBOs, but it appears that training is important for all the people who have a role in a district's financial management. Based on our survey findings, training could be improved in several areas, including:

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

Of note here is that the state has provided principals with AB 75 training that was required to include financial management. From 2001 to September 2006, 701 local education agencies had participated in this training. A third of our survey respondents, however, report that their principals receive little or no training in fiscal management and budgeting, with that answer more common in fiscally unhealthy districts.

This, along with our other findings on site-level budgeting and financial management, may suggest an important area where more information is needed. 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. Our findings are certainly not sufficient to suggest that these practices are the reasons districts are healthy. They do, however, provide a compelling reason to learn more about ways that districts can effectively empower their school site leaders in the area of financial management. An important aspect of such an inquiry would be to examine the extent to which site-level flexibility is constrained by the requirements of credentialing laws, the collective bargaining contract (such as contract language that requires all classes meet certain maximum sizes), and myriad state and federal legal compliance issues.

### Lifetime retiree health benefits—the employee compensation practice most closely linked to fiscal health

It is clear that employee compensation is a huge factor in school district expenditures, and in California, collective bargaining is the process by which compensation is decided. Further, the scope of bargaining here means that collective bargaining agreements affect a broad range of district practices and expenditures beyond compensation per se. That said, we were interested to see that the collective bargaining and compensation practices we analyzed did not, for the most part, correlate significantly with fiscal health.

The most notable exception to this was the granting of lifetime health benefits to retirees. This practice was significantly more likely to occur in unhealthy districts in our sample and in unhealthy unified districts statewide.

This could be interpreted as a symptom of other problems or weaknesses in a district's policies and practices related to compensation. We identified 72 districts statewide that have granted this benefit. These districts serve 1.4 million students, or about 24% of students in the state. A closer look at those districts might be in order, but it would be important that such an enquiry recognize that the leaders who negotiated the benefit may no longer be the ones at the district helm.

### ***Additional reflections on the challenges of financial management in California***

In California, complex formulas dictate how much revenue a school district will receive to educate its students. For the most part, districts are simply the recipients of these funds, the amount of which is determined by factors beyond their direct control. District management can only address the revenue side of the budget at the margin. Practices such as raising private contributions, applying for grants and categorical support, pursuing a local parcel tax, and increasing its ratio of average daily attendance to enrollment have limited effect. That will remain true as long as the fiscal decisions of the state Legislature and the governor—and the provisions of Propositions 13 and 98—are the primary factors in setting school district revenues and districts continue to have only limited ability to increase revenues on their own.

As a result, school districts in California can exercise direct control over their fiscal health largely by controlling their expenditures. The need to do so creates a dynamic tension with 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 revenue 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 addition, it raises important issues related to school district financial management that warrant further study, including examination of district leadership as a key factor that, at least in some cases, can overcome weak financial fundamentals.



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**Appendices – see separate files**