

**Presentation to the Board of Education by the
Santa Monica-Malibu Unified School District
Financial Oversight Committee**

Cynthia Torres, Chair
June 10, 2009

Good evening, Members of the Board of Education. My name is Cynthia Torres and I am the chair of the Financial Oversight Committee. On behalf of the FOC I welcome the opportunity to review our work during the past year with you, and to offer you observations about certain District financial matters.

Introduction

The Financial Oversight Committee, now in its eighth year of operation, is a nine-member committee of professional and community members appointed by the Board to provide you and District management with advice and counsel on a variety of financial matters. According to the charge you gave us, our responsibilities include:

- Reviewing and commenting on the District's financial audit, the interim financial reports to the Los Angeles County Office of Education, the proposed annual budget, and annual enrollment projections;
- Assisting in the development of a long-term financial plan for the District;
- Reviewing issues that could have a significant impact on District finances before the Board makes decisions about them, including proposed labor settlements;
- Serving as the Taxpayer Oversight Committee charged with reviewing the District's administration of and compliance with the terms of Measure R, which was the parcel tax approved by voters in 2008 (and previously the terms of Measure S, which was the parcel tax approved by District voters in June 2003)
- Monitoring and advising about the funding agreements between the District and the City of Santa Monica and the City of Malibu; and
- Assisting the District to educate the general public about school finance issues.

Because of the extraordinary circumstances that have affected the State of California's budget this year, much work remains to be done on the District's budget. Our District faces significant financial challenges that the Board has only begun to confront. On the positive side, District staff conducted encouraging discussions in mid-May with two independent bond rating agencies. Our District is currently rated AA by Standard & Poor's and Aa2 by Moody's Investors Service. In these discussions, the rating agencies expressed particular interest in the voters' approval of Measure R and other parcel taxes and bond measures; the District's renewed funding contract with the City of Santa Monica and continued financial support from the City of Malibu; high general fund reserve levels in the current fiscal year; and the general strength of our two communities' assessed value over the past ten years. We expect that Standard & Poor's and Moody's will re-affirm their positive ratings of our District in mid-June in preparation for a planned issuance in August of the next series of Measure BB bonds. In addition, we will benefit in the short-term from one-time federal funding associated with the President's national economic recovery strategy.

But our State's projected \$24 billion budget deficit, combined with the voters' rejection in May of the budget propositions, suggests that significant cuts to education are inevitable. Turning to our District's finances, the Los Angeles County Office of Education continues to raise concerns about the District's deficit financing practices, funding of labor settlements by drawing down reserves, and the budgetary impact of the continuing decline in student enrollment. The School Board has taken important initial steps to reduce District expenses for next year by approximately \$4.5 million. But these reductions, unfortunately, are simply not enough. Because of additional expected reductions to our state revenues for next year, Chief Financial Officer Jan Maez estimates that our District must cut an additional \$2 million from our budget for 2009-2010. She further stipulates that cuts in the range of \$4 - \$5 million must be made in each of the following two years. I will discuss some of our recommendations to deal with these budget reductions later in this presentation.

Tonight's discussion is our third meeting in a workshop setting with the Board this year. We believe this series of workshops is a useful change in Board procedure that is responsive to our financial predicament. These workshops are useful for communicating information to the public, and provide opportunities for an open exchange of ideas about a complex subject. The specific topics we want to discuss with you tonight include the following:

1. A brief summary of the Financial Oversight Committee's activities during FY 2008-09.
2. Our report on Measure R expenditures during FY 2008-09 and 2009-10.
3. Comments on the current draft of the FY 2009-10 District budget.
4. Recommendations for the FOC to focus upon during 2009-10.

Summary of FOC's Activities During FY 2008-09

This year has been a particularly busy one for the Financial Oversight Committee, during which we accomplished the following:

- Met with the District's auditor to review the FY 2007-08 audit of District finances and Measure S expenditures.
- Reviewed the 1st and 2nd Interim Reports, the P-1 and P-2 enrollment counts, District staff projections of enrollment and Average Daily Attendance (ADA) and various proposed budget transfers.
- Met with the District's investment bankers from Keygent LLC. We reviewed with them the planned financial structure of the next series of Measure BB bonds, discussed the merits of the District's issuance of short-term Tax and Revenue Anticipation Notes (TRANS) for cash flow needs, and discussed the presentation to the rating agencies.
- Reviewed, discussed, and provided comments to the Board on a variety of other financial matters, including:
 - a) A review of the District's significant contracts, including contracts in Special Education;
 - b) A review of numerous budget reduction proposals and adjustments to the District's financial position;
 - c) A discussion of the District's reserves for economic uncertainty, and projected reserve levels;
 - d) A discussion of the District's permit policy;
 - e) A review of the District's salary schedules for certificated, classified, management, and hourly employees, along with the J-90 Report, which is submitted annually to the State of California; and
 - f) Examined certificated employees' salary compression data.
- Through one of our subcommittees, we conducted collaborative work with the Special Education District Advisory Council subcommittee on budgetary and financial issues, including sharing financial reports and studying budgetary detail.
- Began to research alternative compensation models for District staff that have been successfully adopted by other Districts.
- Presented initial recommendations for District-wide revenue enhancements, which we will discuss later in this presentation.
- Through an application and interview process, we replaced three members of our committee.

In addition, several of our members are active on other District committees, including the Measure BB Committee, the Special Education District Advisory Committee, and the Superintendent's Advisory Committee on the Budget. Several of our members also played an advisory role on negotiations leading up to the successful renewal of the City of Santa Monica-District contract.

The FOC's work this year benefitted from a productive working relationship with Superintendent Tim Cuneo, Chief Financial Officer Jan Maez, the District's outstanding fiscal staff, and other senior District staff. Once again, we want to acknowledge Dawn Smithfield, in particular, who provides administrative support to the FOC and who continues to handle the parcel tax senior exemption program with exceptional grace and tact.

Our Committee was very fortunate to have active participation in our meetings by two sets of board liaisons. Our current board liaisons, Jose Escarce and Barry Snell, have provided us with valuable insights about board policy. Prior to the most recent board election, our liaisons had been Maria Leon-Vazquez and Kelly Pye, who also provided us with valuable comments. Other members of the Board have attended our monthly meetings from time to time. Our meetings are open to the public and the press, and our agendas and minutes are posted on the Board's web site.

Report on Measure R Expenditures

The Santa Monica-Malibu Schools Quality Education Funding Renewal Act of 2008, more commonly known as Measure R, was the school funding measure approved by District voters in February 2008. The measure consolidated and replaced two former parcel taxes, Measure S and Measure Y, in the amount of \$346 per parcel this year, and includes both a "Senior Exemption" and an annual CPI adjustment.

With a total of about 32,500 property parcels in the District, and after deductions for the estimated number of senior exemptions and tax payment delinquencies, Measure R generated about \$10.3 million for our District in 2008-09. Under the terms of the Measure, these funds are to be used for the following purposes:

- To preserve programs and replace funds lost or reduced due to inadequate state funding;
- To sustain achievement in reading, writing, and mathematics for all students at all grade levels and to fulfill the District's core curriculum which includes music, the arts, library services, and athletics;
- To attract and retain highly qualified teachers; and
- To protect the taxpayers' investment in education and ensure District accountability by providing for special financial oversight and independent annual audits of revenues and expenditures.

Measure R requires that funds be deposited into a separate account, that a “citizen financial oversight committee” review District administration of and compliance with Measure R, provides for public review of the expenditure plan, and requires an annual audit of expenditures.

The actual expenditures for Measure R in 2008-09 totaled \$10.3 million and are shown below.

The Financial Oversight Committee reviewed the final audit of Measure S that was performed by the District’s auditors, Nigro Nigro & White for the FY ended June 30, 2008. This audit contained a “clean” accounting opinion, and there were no findings reported in the schedule of findings and recommendations. A similar audit of Measure R through June 30, 2009 will be reviewed by the FOC next year.

Santa Monica Malibu Unified School District				
Measure R Expenditures, FY 2008-09 and 2009-10				
Expenditure Category	FY 2008-09 Budget		FY 2009-10 Budget	
	FTEs	Amount	FTEs	Amount
Art & Music Program	13.188	1,142,509	12.1875	1,039,075
Physical Education Program	13.072	547,199	13.0724	557,221
Library Program	20.375	1,256,155	19.375	1,232,156
Technology	12.000	1,067,122	12.000	1,078,818
Administration Cost		67,364		57,044
Sub-total	58.635	4,080,349	56.635	3,964,314
District Program Preservation Due to Inadequate State Funding		6,219,651		6,335,686
TOTAL		10,300,000		10,300,000
Notes: 1. The Consumer Price Index - All Urban Consumers (CPI-U) has not increased, so the parcel tax remains at \$346 per parcel for 2009-10				
2. The Annual Plan will fund the above specified services, with the balance being used to "... preserve programs and replace funds lost or reduced due to inadequate state funding."				

Views on the Proposed FY 2009-2010 District Budget

The general financial context for considering the District's FY 2009-2010 budget is unusually difficult. As noted above, the \$24 billion projected State deficit and the Legislature's budget debate that will take place this summer, forces all California school districts to plan for significant reductions in the years ahead. The voters' rejection of the budget propositions in the May special election seems to have signaled to Sacramento that steep spending cuts are the voters' preferred approach to balancing the budget. Inasmuch as K-14 education accounts for over one-third of state general fund spending, there is no way to balance the budget this way without making draconian reductions in funding for K-12 education in particular. That is precisely what the Governor proposed in his May Revise of the proposed state budget for next year. The guidance we have received from the Los Angeles County Office of Education is to expect an 18% deficit in our revenue limit funding for next year, which equates to a 3.5% reduction in actual receipts. We have also been told to assume a 20% reduction over two years in many categorical program revenues. Whether the Legislature will accept the Governor's latest proposals is very much in question.

By law, our District must adopt its budget by the end of this month even with so much uncertainty about the state of the economy and the state budget. The FOC's ability to provide guidance to the Board on the proposed budget is aided by the excellent work of Ms. Maez and the fiscal services staff, who work diligently to keep up with ever-changing circumstances in Sacramento and Washington, D.C. We on the FOC have welcomed the opportunity to discuss this year's difficult budget decisions with the School Board at our budget workshops, and to share our positions on important budget decisions at School Board meetings. As stated previously, we believe the budget preparation process has benefitted from this collaboration.

The FOC applauds the District's staff's continuing efforts to analyze opportunities for greater operating efficiencies, and the Board's support for making staffing reductions that are needed to correspond with the continued decline in student enrollment. In light of the negative revenue impact from declining enrollment and state funding uncertainty, we support the Board's decision this year to adjust class sizes and to seek additional cost saving opportunities. We also urge the staff and the Board to continue your progress on developing appropriate staffing ratios by focusing intensively on Classified and Management staffing.

We remain very concerned about the projected scale and growth of the operating deficit in the Unrestricted General Fund, which is the District's primary operating account. The three year budget projection shows a deficit of about -\$8.5 million in the next fiscal year alone, and a cumulative total deficit over the three-year projection period of \$31.6 million. These large projected operating deficits are at odds with the Board's very first adopted budgeting principle, which is to maintain a balance between current and future year income and expenditures so as to ensure the long-term financial integrity of the District.

The Los Angeles County Office of Education has routinely cautioned our District about the need to reduce our projected operating deficit. As we noted in our report last year, research by School Services of California shows that persistent deficits may be a better indicator of future fiscal difficulty than an inability to meet the minimum 3% reserve benchmark. We urge the staff and the Board to continue searching for ways to reduce costs and increase revenues.

We note that this year, unlike in prior years, the District's projected deficits are not a result of increases in operating costs. It is important to understand that salaries and benefits now account for 91% of the Unrestricted General Fund. Because so much of the overall budget is devoted to salaries and benefits, there is simply no choice but to look at the painful issue of reducing these costs in particular. Whether this is accomplished by further reductions in positions, furloughs, and/or changes in salaries and benefits will be a difficult set of discussions with the District's bargaining units. Everyone, including Management, will have to make sacrifices.

Absent further actions by the Board to curtail spending, the operating deficit is primarily financed by drawing down reserves. It is important to note that the proposed budget indicates that the District will be able to fund the minimum required three percent reserve for economic uncertainties only through the next budget year. Thereafter, there will be a steady erosion of the unallocated fund balance at a rate of between \$8 million - \$12 million each year during the projection period. Let me be clear: this is a path to financial insolvency. Bringing the District's budget back into compliance with this most basic standard of good financial practice, namely, adequate reserves, will require further steep spending reductions and additional revenues.

We remind Board members that in some respects the proposed District budget is a "best case" scenario. It assumes, for example, no additional cost increases resulting from future labor negotiations with any of the District's bargaining units over the next three years, and no further reductions in state revenues in the out years of the budget forecast. In practical terms, this means that the District could face significant internal pressures to increase costs that are not reflected in these financial projections. The Board will need to be vigilant about maintaining District reserves, controlling costs, and aggressively searching for new revenues in order for the District to remain fiscally sound.

Most of the federal stimulus dollars we will receive are already ear-marked for special purposes, and because they are a one-time event, they are not a solution to the deep budget dilemmas facing the District. We estimate that our District will receive, over a two year period, an aggregate of \$7.5 million in federal stimulus dollars. Most of these funds are designated for special purposes, such as funds for Special Education and for Title I schools. These one-time funds will assist our District to achieve important goals, such as smaller class sizes for elementary age students who are most in need, and funding federally-mandated programs for our Special Education students. Other funds will, out of necessity, serve as a bridge during this next year between our current staffing levels and spending reductions that will take place in the following year.

We now need to lay the groundwork for a more intensive budget process looking forward, since further steep budget reductions will be needed. Instead of beginning the budget process for the 2010-11 school year in January, which is typical, the process really needs to start this summer with an examination of revenue enhancement opportunities. Programmatic changes need time to develop, consider, and implement, and work on these should also commence immediately. A full range of budgetary solutions must be on the table for consideration, including further increases to class sizes, administrative changes, school consolidations, and negotiated changes with our bargaining units. We call on the Superintendent and the Board to develop a comprehensive, transparent and inclusive budgetary process so that options can be thoroughly vetted well before the customary budget preparation season in the spring. We need to learn from this year's Samohi reorganization process that implementation plans are an important aspect of budgetary decisions and should not be left to the last minute.

Another important process that our District needs to undertake next year is to re-visit our strategic plan. The last time we developed a strategic plan was in 2002, and it is time for us to once again consider our key priorities and direction. In this difficult economic environment it is especially important for us to consider together as a community what the District's core activities should be. Ideally, the strategic plan should be able to provide us with important guidance on budgetary priorities.

Although we are mindful of the time pressure that staff faces each year in preparing the budget, we want to reiterate two suggestions about the budget process that have not yet been acted on:

- *Show Information on All Funds, Schools, and District Departments.* We continue to recommend that the budget presentation include the proposed budgets for all District funds, schools, and District Departments, and not just the Unrestricted General Fund. While the General Fund, including both its unrestricted and restricted funds is clearly the most significant component of the total budget, we believe the Board and public should see a more complete picture of the District's total budget.
- *Improve Public Communication.* We once again recommend that the budget presentation make better use of graphics to help explain the proposed District budget. School district finance in California is particularly complicated and difficult for the average citizen to grasp. Although the school and program-based budgets have been useful, the agenda reports to the Board do not explain the budget structure as clearly as they could. We should be using every opportunity to educate voters and the public in general about the condition of District finances.

Proposed FOC Focus for FY 2009-10

Each year at this time, the Financial Oversight Committee recommends a particular charge that we would like the Board to approve. The intent is to obtain the Board's approval that, in addition to our other duties, our work focus on a few topics that will provide the most value-added to the District. At our meeting on June 2, the Financial Oversight Committee decided to bring forward three specific topics that we would like to concentrate on during the next school year.

1. *Assist in the board's development of a robust, multi-year financial plan.* We fully appreciate that we are operating in a difficult, fluid budgetary environment. We are concerned about the projected scale and growth of the operating deficit in the Unrestricted General Fund. We intend to continue searching for ways to reduce costs and to increase revenues, and to work with the Board to analyze all available budgetary strategies.

2. *Refine specific revenue enhancement recommendations.* Nearly all of the budget balancing discussions to date have focused on cost reductions. We believe the revenue side of the budget needs equal attention, although we realize the District's ability to independently raise revenue is limited. Nevertheless, District voters and our two city governments clearly recognize the benefits of an appropriately funded local public school system and have responded with great generosity. We should honor those commitments with more attention to still other local revenue opportunities. At our last FOC meeting we discussed numerous revenue enhancement suggestions, including a school funding measure in 2010, conducting an aggressive attendance improvement campaign, alumni fund-raising, establishing a district-wide academic foundation, pursuing advertising revenue opportunities, and establishing new corporate partnerships, among others. We would like to focus on a few of these that have the most promise, develop estimates on how much we could raise, and come back to you with specific recommendations for further action.

3. *Continue to Work on the Development of a Financial Management Plan for Special Education.* A subcommittee from the Financial Oversight Committee worked with the Special Education District Advisory Committee to develop better tools for analyzing the Special Education financial picture. Our District is spending approximately \$22 million in Special Education funding this year. Special Education costs in our District have increased significantly over the past few years, while enrollment has decreased. In addition, there is now a renewed commitment to a comprehensive review of the most appropriate program of Special Education services for our students.

Essentially, we would like to explore ways to deliver a better Special Education services using the resources we already have.



On behalf of the FOC, I thank you for the opportunity to serve the Santa Monica-Malibu Unified School District. We are available to answer any questions you may have about this opening statement, and look forward to a discussion with the Board.