

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

Paul J. Silvern, Chair

June 15, 2006

Good evening Members of the Board of Education. On behalf of your Financial Oversight Committee (FOC), I want to thank you for the opportunity this evening to review the FOC's work during the past year, and to offer our observations about certain District financial matters.

Introduction

The Financial Oversight Committee, now in its fifth 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 annual financial audit, the annual budget and annual enrollment projections;
- Assisting in the development of a long-term financial plan for the District;
- Reviewing issues that could have an adverse impact on District finances before the Board makes decisions about them;
- Serving as the Taxpayer Oversight Committee charged with reviewing the District's administration of and compliance with the terms of Measure S, the 2003 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.

Based on monthly meetings and extensive discussions with District management and financial staff, the FOC believes the District continues to make significant progress in improving its management of financial matters. This includes efforts to identify new revenue sources, contain costs, build up reserves for emergencies, and improve management of expenditures, all within a very uncertain fiscal environment. This uncertainty is directly related to the fact that annual budget decisions made in Sacramento and Washington, have profound impacts on District revenues and the District's ability to spend funds to achieve its educational objectives. And these decisions, for better or worse, often occur very late in the school year and close to the time when the Board must adopt its annual budget. These are not ideal circumstances for making good strategic and financial decisions.

The FOC's work continues to benefit from a very productive working relationship with Winston Braham, the District's Chief Financial Officer, and his technical and administrative staff. Among the latter, I would like to once again acknowledge Dawn Smithfield, in particular,

who also provides administrative support to the FOC and handles the Measure S senior exemption program with unusual care and tact.

We also benefit from regular discussions with the Superintendent, past and present, and other senior District personnel and program staff. We are also very fortunate to have active participation in our meetings by our Board liaisons Julia Brownley and Oscar de la Torre, who provide invaluable insights about Board policy.

The topics I will cover this evening include the following:

1. A brief summary of FOC's activities during FY 2005-06;
2. Our report on Measure S expenditures during FY 2004-05 and proposed expenditures for FY 2006-07;
3. Comments on the current draft of the FY 2006-07 District budget; and
4. Our proposed focus for the next fiscal year

FOC's Activities During FY 2005-06

We were fortunate to have full and stable membership over the course of the year, which allowed us to focus on the substance of financial matters and less on internal organizational issues, which required much of our attention during the prior year. At the end of this fiscal year, however, we are losing two members. Mike Phillips brought a very valuable private sector financial perspective to our work, even though it required some effort on his part to make the translation to the more arcane format of public school accounting. Chris Harding brought to the FOC not only the keen intellect of a successful attorney, but a lifetime of involvement in civic, business and community activity in Santa Monica. He served on the FOC since its inception in 2000. Finding someone to replace his contribution to the FOC will be a serious challenge.

During this fiscal year we accomplished the following:

- Met with the District's auditor to review the FY 2004-05 audit of District finances and Measure S expenditures;
- Reviewed the 1st and 2nd Interim Reports, the P-1 and P-2 enrollment counts, and projections of enrollment and Average Daily Attendance (ADA);
- Reviewed and discussed the initial draft of the District's FY 2006-07 budget, including plans for expenditures from Measure S revenues;
- Monitored and discussed District progress in implementing its deficit reduction plan, particularly cost savings and cost containment strategies for the Special Education program. We are impressed with progress to date in reducing some of those program costs, and plans to internalize more resources that should produce significant savings, though only after some short-term increases in operating cost. We recommend that

these financial outcomes be carefully documented to assist the Board in future decision making.

- Monitored the development of the District’s Facilities Master Plan, and contributed to Board discussion about whether to schedule a bond measure to pay for improvements included in the Plan.

Measure S Expenditures

The Quality Public Education Preservation Act of 2003, more commonly known as Measure “S”, is the parcel tax that was approved by District voters in June 2003, by 67.6 percent, barely exceeding the minimum two-thirds threshold needed for adoption. Measure “S” imposes a \$225 tax on each parcel of land in Santa Monica and Malibu within the District’s boundaries, with exemptions for qualifying seniors. The tax remains in effect through 2009.

With a total of about 32,400 parcels, and after deductions for the estimated number of senior exemptions and tax payment delinquencies, Measure “S” generates about \$6.5 million annually for the District. Under the terms of the Measure, these funds are to be used to:

- Restore/replace programs cut due to State funding reductions;
- Sustain student achievement and fulfill the District’s core curriculum, including music, arts and athletics; and
- Provide independent expenditure accountability.

The Board assigned the FOC a role in providing independent expenditure oversight, including review of the proposed annual expenditures, and prior year actual expenditures, for consistency with the Measure’s purposes. To do so, we look Measure “S” expenditures at two points during the school year.

First, we review the audit of last year’s actual Measure “S” expenditures. The District’s auditor concluded that actual expenditures were consistent with the Board’s adopted expenditure plan that was included in the FY 2004-05 budget, both as to dollar amounts and distribution by category. That spending plan included the allocations shown in Table 1.

Expenditure Category	Amount	Percent
Teachers Salaries & Benefits		
K-3 Class Size Reduction (19.5 FTEs)	\$ 1,502,812	23.0%
Middle Schools (10.0 FTEs)	\$ 771,333	11.8%
High Schools (20.0 FTEs)	<u>\$ 1,542,666</u>	<u>23.6%</u>
Subtotal (49.5 FTEs)	\$ 3,816,811	58.3%
Music Program	\$ 952,239	14.6%
Physical Education Program	\$ 602,013	9.2%
Library Program	\$ 1,165,647	17.8%
Audit Cost	<u>\$ 4,686</u>	<u>0.1%</u>
Total	\$ 6,541,396	100.0%

Source: Roy J. Blair, CPA, FY 2004-05 Measure "S" Audit, p.2

Accurate tracking of these expenditures was made possible by assigning them a specific account code. There were no audit exceptions or recommendations from the auditor for changes to Measure “S” accounting procedures or practices. Thus, the Board and public can be assured that last year’s expenditures were consistent with what the District’s voters approved in 2003.

In its review of the audit of last year’s expenditures, FOC again recommended that future audit reports include more explicit accounting of actual versus budgeted revenues, rather than focusing almost exclusively on expenditures. This should include documentation of gross potential revenues, deductions for senior exemptions and delinquencies, and the net revenues available for expenditures.

Our second annual review of Measure “S” involves expenditures planned for next fiscal year. For FY 2006-07, FOC reviewed the proposed Measure “S” expenditure plan developed as part of the initial budget that was presented to the Board on June 1, 2006. We found that the proposal is, once again, very similar to the expenditure plan in each of the last two years (see Table 2), and consistent with the terms of the Measure.

The FOC therefore recommends that Board approve the FY 2006-07 Measure “S” expenditure plan in general. As with last year’s plan, however, we again suggest that the Board consider using other funds for certain, relatively small, music program operating expense line items (e.g., supplies, mileage, dues and memberships), even though these items were funded in past years with Measure “S” proceeds. While these line items are important to the overall functioning of the music program, it is the FOC’s opinion that the voters probably expected these funds to be focused on more core program needs, such as instructional staff.

Table 2
Measure "S" Expenditure Plans, FY 2004-05, FY 2005-06 and Proposed FY 2006-07

Expenditure Category	FY 2004-05 Actual			FY 2005-06 Budget			FY 2006-07 Proposed		
	FTEs	Amount	Percent	FTEs	Amount	Percent	FTEs	Amount	Percent
Teachers Salaries & Benefits									
K-3 Class Size Reduction	19.500	\$ 1,502,812	23.0%	21.500	\$ 1,677,000	25.8%	21.500	\$ 1,702,156	25.9%
Middle Schools	10.000	\$ 771,333	11.8%	10.000	\$ 780,000	12.0%	10.000	\$ 791,700	12.0%
High Schools	<u>20.000</u>	<u>\$ 1,542,666</u>	<u>23.6%</u>	<u>15.500</u>	<u>\$ 1,192,453</u>	<u>18.3%</u>	<u>15.500</u>	<u>\$ 1,192,453</u>	<u>18.1%</u>
Subtotal (49.5 FTEs)	49.500	\$ 3,816,811	58.3%	47.000	\$ 3,649,453	56.1%	47.000	\$ 3,681,405	56.0%
Music Program		\$ 952,239	14.6%	13.130	\$ 988,189	15.2%	13.130	\$ 1,023,906	15.6%
Physical Education Program		\$ 602,013	9.2%	12.995	\$ 620,124	9.5%	12.995	\$ 603,532	9.2%
Library Program		\$ 1,165,647	17.8%	20.375	\$ 1,199,438	18.4%	20.375	\$ 1,211,238	18.4%
Measure "S" Admin.		\$ <u>4,686</u>	<u>0.1%</u>		\$ <u>51,233</u>	<u>0.8%</u>		\$ <u>52,919</u>	<u>0.8%</u>
Total		\$ 6,541,396	100.0%		\$ 6,508,437	100.0%		\$ 6,573,000	100.0%

Sources: FY 2004-05 Measure "S" Audit; Adopted FY 2005-06 District Budget; Proposed FY 2006-07 Budget (6-1-06)

Proposed FY 2005-06 District Budget

The general financial context for considering the FY 2006-07 District budget is more favorable than it has been in many years. Higher than anticipated tax revenues collected by the State will translate into additional funding for school districts, according to the Governor’s recommendations and the results of the Assembly-Senate budget bill conference committee. This will provide the District with a little more fiscal breathing room, at least for next year.

There may also be additional funding available for certain targeted programs, which may or may not be entirely consistent with District educational objectives.

On the other hand, there have been reductions in some federal funding programs, District enrollment continues to decline, and demands on the District's General Fund to help support other funds, particularly Special Education, continue to escalate. Close observers of the State budget caution that the revenue picture for the next couple of years will not be as rosy as the one beginning July 1st. These factors suggest that the District must continue to exercise budget discipline as it plans for FY 2006-07 and beyond.

The FOC's ability to provide substantive comment tonight on the District budget proposed for next is limited. This is because the only version of the budget we have thus far considered is the version that is least important to your decision making. That version was produced for your May 18 meeting, but was not discussed until the June 1st meeting. More importantly, that version of the budget did not reflect the May 12th revisions to the Governor's budget proposal, and included a large number of additional staff positions and other expenditures requested by departments that the District clearly cannot afford.

The FOC has not had an opportunity to review the second version of the budget that became available this week, and is included in tonight's Board agenda. The second draft does now, however, reflect the additional revenues expected to become available from the State and it eliminates the additional staff positions and certain other additional expenses from the initial draft. It presents a much more balanced set of revenues and expenditures that results in a general fund deficit of under \$700,000, which we understand will likely be acceptable to State Department of Education budget officials. It also represents a significant improvement over the situation in this year's budget, with its General Fund deficit of about \$1.1 million.

We would like to offer a few observations, however, about the District's budgeting process. First, we recommend that the District restructure its budget preparation schedule so that the first presentation of the proposed budget reflects the annual May revision of the Governor's budget proposal, and District management's recommendations for achieving acceptable budget balances. We see little value in a draft budget that does not reflect both of these considerations.

Second, we recommend that the draft budget presentation include a summary of all District funds, and not just the 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.

Third, we recommend that the budget be presented in the context of the educational and management objectives and priorities for the coming year. We believe that doing so will assist the Board to better align expenditure decisions with its planning objectives, and provide more clarity to the public.

Fourth, we recommend that the Board of Education devote a special meeting each year to take public testimony about the draft budget, discuss it thoroughly, and give direction to staff for producing the final draft for adoption. It is our view that the annual budget requires more time for discussion and understanding than is typically available to the Board during a regular

meeting. We recognize it may not be possible to do so this year, because of other schedule issues, including the extra time the Board is devoting to the Superintendent search.

Finally, we recommend, as we have consistently since our initial year of operation, 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 recent addition of school- and program-based budgets has been useful, the other budget information documents do not explain the budget structure as clearly as they should. As we look toward a possible facilities bond measure and renewal of the parcel taxes, 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 2006-07

In addition to Measure S responsibilities and general advice on fiscal matters as requested by the Board from time to time, the FOC proposes to focus on the following issues next year.

- Assist staff with budget process improvements, like those noted above;
- Review the status of cost containment strategies, and documentation of cost savings, particularly in Special Education;
- Advise the Board about the scheduled review of the City-District contract;
- Participate in decision making about the proposed Facilities Bond; and
- Assist in preparing a revision to the District's five-year Strategic Plan, including a new element that addresses the financial and educational program implications of continued declines in student enrollment, and a more thorough discussion of the Plan's financial implications.

On behalf the Financial Oversight Committee, thank you for the opportunity to serve the Santa Monica-Malibu Unified School District.