

Special Report



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Lake County School District Needs Better Planning and Communication to Address Budget Problems

at a glance

The Lake County School District's unreserved portion of its fund balance has been significantly reduced during the past two years. This reduction has occurred for two reasons.

- The district does not have consensus on strategic direction and budget priorities on which to base budget decisions. Thus, budget decisions are made without agreement on the district's short-term and long-range goals and objectives.
- District officials do not communicate sufficiently with each other during budget preparation and amendment processes. As a result, budget decisions are made without always fully considering the financial implications.

To correct this situation the district should

- adopt a strategic plan;
- identify annual priorities before the budget is drafted, including the amount to be held in reserve; and
- improve and increase communication among staff and between staff and the board, including developing written procedures to aid staff in budget development.

Purpose

On April 4, 2000, the Lake County School Board requested that OPPAGA and the Auditor General conduct an in-depth Best Financial Management Practice (BFMP) review of the Lake County School District. This review will begin in January 2001. In the interim, the school board requested that OPPAGA and the Auditor General conduct a special review of the district's financial condition and budget process. This review was designed to answer two questions.

- Why has the unreserved portion of the fund balance of the Lake County School District general fund been significantly reduced over the past two years?
- What actions can the school board take to maintain a strong financial condition?

The 2000 Legislature allocated \$200,000 for OPPAGA and the Auditor General to conduct a complete BFMP review of the Lake County School District during Fiscal Year 2000-01. This review, expected to begin in January 2001, will be a comprehensive examination of 14 school district educational and operational areas.

Background

The Lake County School District is a medium-sized district located northwest of Orlando. In 1999-2000, the district

- served approximately 28,000 students;
- employed more than 3,300 persons, including 1,833 full-time instructional staff;
- operated 23 elementary schools, 9 middle schools, 6 high schools, and several types of special education programs; and

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- had a General Fund operating budget in excess of \$146 million.

The Lake County School District's student growth rate is well above average when compared with other districts of similar size and with statewide growth.¹ From 1995 to 1999 the district's average annual increase in student population was 3.70%. By comparison, similarly sized school districts had an average annual growth over that period of 2.29%, and the state's average annual growth rate was 2.31%.

Since Fiscal Year 1997-98, the Lake County School District has

- increased staff by over 17% by adding nearly 260 instructional staff;
- increased its operating budget by 14%; and
- opened three new elementary schools and one new middle school.

The district's total budget for Fiscal Year 1999-2000, including general funds, special revenue funds, capital outlay funds, debt service funds, and internal service funds, was approximately \$288 million.

This report focuses on changes in the district's financial position for Fiscal Years 1998-99 and 1999-2000 and specifically examines the district's \$146 million General Fund operating budget, which supports the district's general operations (e.g., salaries, expenses). The report does not examine the district's special revenue funds, capital outlay funds, debt service funds, and internal service funds. Exhibit 1 shows the sources and amounts of funds for the General Fund operating budget for Fiscal Year 1999-2000 as reflected in the district's annual budget.

Exhibit 1 1999-2000 Fund Sources General Fund Operating Budget

| | |
|--------------|----------------------|
| Federal | \$ 70,000 |
| State | 91,928,979 |
| Local | 48,039,176 |
| Fund Balance | 6,026,421 |
| Total | \$146,064,576 |

Source: Lake County School Board.

¹ The Lake County School District was compared to Alachua, Bay, Clay, Collier, Leon, Okaloosa, Osceola, and St. Lucie school districts.

Findings

The unreserved portion of the district's fund balance has been significantly reduced over the past two years

The Lake County School District began Fiscal Year 1998-99 with a fund balance of \$10,585,206 of which \$7,893,582 was unreserved. However, the district has significantly reduced this unreserved portion of the fund balance over the past two years.² This situation requires immediate attention by the school board, as maintaining a sufficient fund balance is necessary to provide a "rainy day" fund for emergencies and unforeseen events.

The fund balance includes both reserved and unreserved funds. Fund balances are typically reserved for unspent balances of restricted source revenues and commitments incurred in the prior year that will be honored in the subsequent year. The unreserved portion of the fund balance generally represents unrestricted resources available for general appropriation. The unreserved portion may be designated for use in certain programs or activities or may be undesignated, which represents the amount that can be used with the most flexibility for emergencies and other unforeseen situations. Exhibit 2 depicts the change in the total fund balance and the unreserved portion of the fund balance over the past two fiscal years, including the amount represented by inventory.

Reasons for Changes in Fund Balance

A series of factors account for the change in the Lake County School District's fund balance over the past two fiscal years. During this time, the total fund balance fell from \$10,585,206 at the beginning of Fiscal Year 1998-99 to \$6,026,421 at the beginning of Fiscal Year 1999-2000, and stands at approximately \$7,100,000 at the end of this fiscal year, according to the district's finance director. The unreserved portion of the fund balance declined from \$7,893,582 at the beginning of Fiscal Year 1998-99 to approximately \$2,200,000 as of June 30, 2000. Primary causes of this fund balance decline have been the district's approval of budgets that used the fund balance to cover

² In governmental accounting, a fund balance represents accumulated equity in a fund. During each budget cycle, that equity is affected by the difference between the agency's revenues and expenditures.

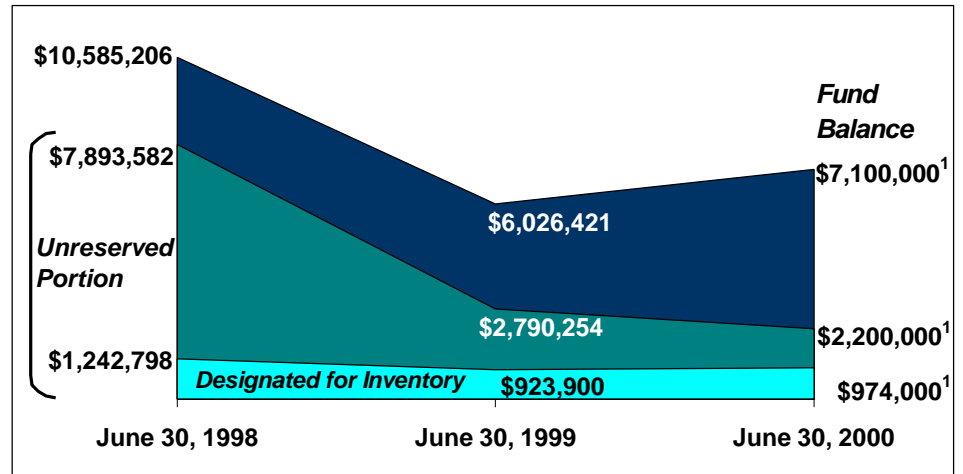
expenditures that exceeded revenues, subsequent budget amendments that further increased expenditures, and overestimation of revenues.

At the beginning of Fiscal Year 1998-99, the school board adopted a budget that planned for the use of \$6,257,404 of the fund balance to cover projected expenditures in excess of anticipated revenues. Also, during the fiscal year, the school board approved five budget amendments that had a net effect of using an additional \$1,322,356 of fund balance resources. These budget amendments included partial funding for the district's salary increases (\$1,020,866), which were not covered in the district's original budget. The district did not spend all amounts budgeted during the year and as a result used \$4,558,785 of its fund balance resources during the year, reducing the balance to \$6,026,421 at the end of the year. In addition, the unreserved portion of the fund balance was reduced to \$2,790,254 and the undesignated portion, which can be used with the most flexibility for emergencies and other unforeseen situations, was reduced to \$1,866,354.

Based on unaudited financial data provided by school district finance personnel, during Fiscal Year 1999-2000 the unreserved portion of the fund balance was further reduced by approximately \$600,000. At the beginning of the year, the school board again adopted a budget that required the use of \$3,568,661 of the fund balance to cover projected expenditures in excess of anticipated revenues. During the fiscal year, the school board approved six budget amendments that had the net effect of using \$1,060,850 of fund balance resources. These amendments again included partial funding of the district's salary increases (\$1,326,021) that were not covered in the original budget. Also, the district experienced a revenue shortfall of \$2,633,355 below the amount originally budgeted because it overestimated student enrollment. The district avoided a large reduction in the unreserved portion of the fund balance by not expending all amounts budgeted.

Exhibit 2

Decline of the Lake County School District Fund Balance



¹ District estimate.

Source: Developed by OPPAGA from data provided by the Lake County School District.

As of August 11, 2000, the district was still in the process of closing out its books for the 1999-2000 fiscal year and year-end account balances were still subject to significant change due to year-end closing adjustments. However, district finance personnel estimated that at fiscal year-end the total fund balance stands at approximately \$7,100,000 with the unreserved portion totaling approximately \$2,200,000. District finance personnel indicated that they would recommend to the school board that the unreserved portion be designated for inventories and insurance expenses. This will leave no undesignated fund balance, which could be used with the most flexibility for emergencies and other unforeseen situations.

Recommended fund balance level. There are no legal requirements for school districts to maintain a specific amount of fund balance and educational budget experts have varying opinions on the appropriate size for a school district's fund balance. However, auditors, educational administrators, and credit rating agencies generally recommend an unreserved fund balance of 3% to 5% of the current year's budget depending on certain district risk factors. Some factors that the Lake County School District should consider when establishing the level for its fund balance include historical, financial, and student enrollment patterns; exposure to emergencies, such as natural disasters; and potential industry or community changes. Even though there is no

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consensus on exactly how much a district should reserve for unanticipated expenditures and/or emergencies, an unreserved fund balance of 3% to 5% will usually provide an adequate reserve to protect a school district and allow some flexibility in meeting unforeseen expenses. For instance, if the Lake County School District decided to maintain an unreserved fund balance of 5%, this would require it to set aside approximately \$7.3 million based on its Fiscal Year 1999-2000 General Fund operating budget.

It is normal that a school district will need to use its fund balance to meet unforeseen and emergency situations that arise during the year. However, it is critical that the district subsequently replenish the fund balance when it falls below the minimum specified level. Otherwise, the district may be unable to cover unforeseen expenses or revenue shortfalls that occur in future years without resorting to drastic mid-year budget reductions.

Problems that lead to the situation. Our review of the financial condition in the Lake County School District identified two major problems that have led to the decline of its fund balance.

- The district does not have a formal mechanism to identify long-range and short-range priorities that should guide its use of resources; and
- Communication among district staff and between the staff and the school board on budget matters is not sufficient.

The district needs clearer strategic direction and budget priorities

Generally, school districts do not have sufficient resources to fund everything that school boards and administrators desire to accomplish. Therefore, it is important that school districts agree on their goals and priorities and then plan to address both long-term and short-term needs in an organized, logical manner. Long-term needs are usually addressed by strategic planning. Short-term priorities should be developed to meet immediate needs within the constraints of existing resources.

The Lake County School District has not developed a comprehensive strategic plan and budget priorities. As a consequence, it has made budget decisions without consensus on whether

or how, taken together, these decisions will meet district goals or budget management needs.

Strategic planning lacking. Although the Lake County School Board is working to develop a strategic plan, the district has not yet adopted a final, comprehensive strategic plan that establishes long-term priorities and guides budget decisions. Correlating the budget to strategic planning is essential to ensure that spending is consistent with the district's mission, goals, and objectives. Also, Florida Statutes require annual budgets submitted by a school board to the Department of Education to be consistent with and contribute to the implementation of a planned long-range school program for the district.

An effective strategic plan would enable the Lake County School District to focus on critical issues to achieve objectives defined by consensus of the school board and district staff. Strategic planning would allow the district to establish a long-range view toward management of resources to effectively execute the district's programs and activities. A strategic plan also would enable the school board to focus on priorities and be proactive in addressing problems.

In addition to failing to identify long-range goals and objectives in a strategic plan, the Lake County School District has not prioritized short-term objectives. Such objectives should be integrated with the long-range plan to ensure that the annual budget will address the board's priorities.

The responsibility for setting these priorities resides with the school board and district administrators. As the district's policy-making body, the Lake County School Board should provide guidance to district staff on developing the district's budget.

District staff and school board members told us that several items have been priorities over recent years, including increasing teacher benefits, reducing the student/teacher ratio, and maintaining fund balances. Additionally, the district has opened four new schools over the past two years to address priorities relating to overcrowding and reducing the use of portable buildings. However, the district did not develop formal plans that identified the cost of these priorities or how they could be achieved within existing resources. As a result, the district has

implemented these priorities on an *ad hoc* basis and has frequently resorted to using its fund balance resources to pay for them.

Staff benefits. District staff and school board members have expressed a desire to increase Lake County School District instructional staff salaries to be more competitive with other school districts. The district has also offered an early retirement benefit to its staff and offers a district-paid employee health plan. While these may be reasonable priorities, their costs contributed to the district's weakened financial position. In addition, the district did not accurately forecast the cost of the employee health plan.

Over the past three years, the district's salary and employee benefit costs have increased on average more than 7% per year, although revenue increases have not increased correspondingly. For example, in Fiscal Year 1997-98, district salaries and benefits increased by more than \$9.9 million (10.35%) over the previous fiscal year while revenue from the Florida Education Finance Program increased by only \$4.3 million (4.66%). Fund balance resources were used to cover expenditures that exceeded available revenues.

In Fiscal Year 1997-98, the Lake County School Board offered a one-time retirement incentive plan to eligible employees who retired at the end of the school year. Under this plan the district purchased annuities for the retiring employees at a cost of \$1,085,902 in Fiscal Year 1998-99. While the early retirement program may benefit the district in the long term, the costs of the program resulted in an increase in the 1998-99 expenditures that adversely affected the fund balance resources.

The district has not adequately budgeted for its group health insurance program. The district's budget failed to provide funding for prescription claims in Fiscal Year 1998-99 and was underfunded for group health insurance claims in Fiscal Year 1999-2000. Paying for prescription claims cost the district more than \$2 million in Fiscal Year 1998-99 and additional claims in Fiscal Year 1999-2000 were estimated to increase the health insurance program cost by approximately \$1.8 million above the anticipated amount. Both of these actions further weakened the district's

overall financial condition. Furthermore, the finance director estimates that the district will need to spend an additional \$3 million in Fiscal Year 2000-01 to cover the anticipated costs associated with health insurance claims.

Reducing student/teacher ratios. The Lake County School District has reduced the student-to-instructional staff ratio from 17.44:1 to 15.55:1 from 1997-98 to 1999-2000. To do this, the district has increased its instructional staff by nearly 17% while the number of students has increased approximately 4%. Funding generated by the students served did not cover the salary and benefit costs of the additional staff. The excess cost further reduced the fund balance.

Minimum fund balance levels. Although the school board has indicated that maintaining a fund balance is a priority, it has not reached consensus on the minimum fund balance that should be maintained, and it has not kept focus on the fund balance when taking actions on its other priorities. With no direction about the minimum fund balance to be maintained, district staff developed budgets that planned to use all available funds, including fund balance resources, to cover expenditures. District staff developed the budget assuming that all projected revenues would be received, that all district needs were to be covered in the budget, and that budgeted amounts would be sufficient to cover anticipated expenditures.

Further contributing to the problem is the fact that the district has not established procedures to ensure that the fund balance would not fall below an established level without triggering consideration of expenditure reductions. In Fiscal Year 1998-99, the district used fund balance resources to fund expenditures that exceeded revenues received. The budgets for Fiscal Years 1998-99 and 1999-2000 contained planned fund balance reductions of \$6,257,404 and \$3,568,661, respectively. Additionally, the district amended the budget each year to increase expenditures by approximately \$1 million to provide for district salary and benefit increases. The district's use of fund balance resources without replenishing them has resulted in the fund balance decline.

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The district's continued reliance upon the fund balance for recurring expenditures such as salary and benefits will result in serious fiscal consequences. Recurring expenditures should almost always be financed by ongoing sources of revenues.

District staff need to improve communication

A second problem is that district staff do not communicate effectively with each other and with some members of the school board. This lack of communication and coordination in the budget process has resulted in mistrust among Lake County School District staff and between the school board and the district staff, and led to some board members not fully understanding the fiscal significance of some budget decisions. Poor communication has caused staff to adopt a defensive posture and to fail to take significant factors into consideration when developing the budget.

Three areas in which communication needs to be improved within the Lake County School District are

- written communication, including plans and procedural guidelines, needs to be developed for the budget process;
- verbal communication among staff needs to be increased during the budget process; and
- verbal communication between district staff and the school board on budget matters needs to be improved.

Written communication. The district does not presently have written procedural guidelines to direct staff on routine budget tasks. Written guidelines and procedures convey institutional memory on how processes should be accomplished. Without written guidelines, staff have used inconsistent methods to perform such tasks as budget development and amendment preparation. For example, the prior finance director had many years experience in developing the district's budget and was aware of the assumptions that were built into the budget to cover unanticipated expenses and revenue shortfalls. Typically, the previous budgets did not anticipate using all estimated revenues and the previous budget director knew to provide a cushion in case student enrollment was not as large as anticipated (the amount of state funding provided to districts is largely based on the

number of students served). However, when he retired, his knowledge of budget practices was not written down so that it could be passed on to his successor. Without such institutional knowledge, the current finance director must rely on the memories of other key district staff or learn by mistakes made along the way.

Communication Among Staff. The lack of formal budget procedures has been exacerbated by internal communication problems. Staff who have had critical budget information have not effectively communicated this information to other staff, resulting in budgets being developed and fiscal decisions being made without knowledge of key factors. For example, during development of the Fiscal Year 1998-99 budget, the district's risk manager did not communicate to budget staff the need to include funds in the budget to pay for prescription claims as part of the employees' health insurance program. Since this need was not identified, the budget director did not include funding for that item in the budget. Consequently, when the omission in the budget was identified, the district was forced to use approximately \$2 million in fund balance resources to cover prescription claims.

Another example of poor internal staff communication relates to projecting Florida Education Finance Program (FEFP) revenue. The new finance director was not informed by staff that the district normally over-projected its student enrollment (FTE) by about 1% to allow for unexpected growth, and that the district might not actually serve that many students or receive the full amount of projected funds. Therefore, the budget was developed based on the full enrollment projection with no consideration built into the budget for a possible revenue shortfall. When the actual enrollment growth was less than planned, the district received \$2,633,355 less than projected in Fiscal Year 1999-2000.

Communication Between Staff and School Board Members. While board member opinions differ on whether they receive sufficient information from district staff to make budget decisions, more information should be provided. Some school board members said that they get sufficient information to make good decisions. However, other board members expressed frustration over a lack of information on which to base budget decisions, saying that the way information is

presented makes it difficult to understand fully how their budget decisions affected the fund balance.

These school board members were specifically concerned about the way the fund balance was affected by budget amendments. The effect of budget amendments on the fund balance was not always clear to board members for two reasons.

1. Most amendments include several different changes to be approved. These multiple changes often affect the same activities and objects and the amounts for individual accounts on the amendment form may not be easily linked with the explanatory information provided by district staff. The information provided to board members by district staff does not identify the effect on the fund balance of each individual item in the amendment.
2. The amendment form shows changes by using accounting code numbers rather than generic account names that identify the accounts. For example, a budget amendment may indicate that it affects account 5100-100, which in fact represents instructional salaries. However, some board members do not know what the account numbers mean and therefore may not understand how an amendment affects the district's financial position.

While the district uses a budget amendment form similar to that used by other school districts in Florida, the form alone does not provide sufficient information on which school board members can base budget decisions. District staff provide brief background information on a cover sheet to help the school board make its decision, but the amounts shown on the cover sheet cannot easily be cross-referenced to the amendment form. The amendment form would be more useful for school board members if it identified affected accounts by name and showed the impact of each change, if any, on the fund balance.

Recommendations—————

OPPAGA and the Auditor General recommend several actions that the Lake County School District should take to help alleviate its financial problems. These include setting priorities, adopting policy on the minimum level of the fund

balance, developing a strategic plan, and improving communication.

Set priorities

The school board should agree upon and formally adopt priorities to guide budget and other decisions. First, the district should immediately develop priorities to guide decision-making for the remainder of Fiscal Year 2000-01. These interim priorities should be limited to 5 to 10 specific statements that identify issues to guide major program and budget decisions. When decisions are made that are inconsistent with these priorities, rationale should be provided or the priorities should be formally amended. These interim priorities should be used in developing short-term, or annual, priorities and be consistent with the board's long-term goals for the district, once developed as part of the strategic planning process. In developing its priorities, the board should consider issues such as

- fund balance levels;
- teacher salary increases;
- health benefits levels; and
- class size reduction.

Once adopted, district staff should be instructed on how these priorities should be considered in making program and budget decisions.

Adopt a school board policy on the minimum fund balance

The school board should adopt a policy regarding the minimum acceptable level at which the fund balance will be maintained and the circumstances under which funds from the fund balance may be used. We recommend that this policy include an established level for the unreserved portion of the fund balance to be used for contingencies, emergencies, or one-time purposes and not as a source for financing recurring expenditures.

Develop a strategic plan

The school board should provide general guidance to district staff for developing a strategic plan covering the next five years. The strategic plan should identify the school board's vision and the district's mission as well as the district's long-term goals, objectives, and priorities. When the school board is satisfied that the strategic plan complies with board guidance the school board

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should adopt the plan and use the plan as a guide for making budget decisions for the district. For example, when program directors submit their budgets for board approval, they should describe how major expenditures relate to goals and objectives in the strategic plan. In addition, as part of the budget approval and amendment processes, the school board should use the strategic plan to guide decisions on what to fund.

The plan should provide for annual review and revision by the school board as district needs change. When goals are achieved or priorities are no longer applicable they should be deleted from the plan. When new goals and priorities are identified they should be incorporated into the plan. The district should include the following in its strategic plan.

- The district's mission
- The district's goals and objectives based on state educational goals
- A listing and description of the actions the district will take to achieve its goals and objectives
- A time-line for building the fund balance to the desired level
- Goals, time-lines, and projected costs for priority issues such as bringing instructional salaries to the level desired by the board, reducing the average number of students in a class to the level desired by the board and the state, and benefit levels, particularly health benefits, to be provided for employees
- Methods to assess whether goals and objectives have been met

Improve communication

District staff and the school board should develop strategies for improving communication and rapport among district staff and between the district staff and the board. These strategies should ensure that the staff and the board work together to achieve district goals and objectives.

District staff should develop written procedures to use in performing routine budget actions, including the budget development process, the assumptions to be used in projecting expenses and revenues, and the process to be used for collecting and reporting information needed for developing the budget. The procedures should also cover the process to be followed for creating and reporting budget amendments and transfers. These procedures should identify who is responsible for performing each process and when during the year each process should be accomplished. These procedures should also specifically identify the type of information that should be provided to the school board regarding the budget, its assumptions, and the impact of budget decisions on the operating fund balance. These procedures should be approved by the school board and monitored by the superintendent.

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Project conducted by David Summers, Ben Powell, and Jane Fletcher of OPPAGA(850/488 -0021)
and by Jim Kiedinger and David Martin of the Auditor General (850/488-5534)
John W. Turcotte, OPPAGA Director