

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

Cynthia Torres, Chair

June 3, 2010

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.

I. Introduction

The Financial Oversight Committee, now in its ninth 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, counsel, and recommendations 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 sound 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 and the disappointing results of the recent Measure A campaign, the Board of Education last week agreed to slash its proposed 2010-11 spending plan by \$7.1 million. The adoption of the expenditure reduction plan was a

painful but necessary course of action from a fiscal perspective, and should therefore be recognized and commended as a significant milestone. The adoption of the expenditure plan does allow the District to file a budget.

However, while the Board did take significant steps to address the District's fiscal stability for next year, we are not yet of the woods. Much work remains to be done to confront continuing looming concerns on the District's budget for the 2011-12 fiscal year and beyond. Unfortunately, our District continues to face significant financial challenges that the Board must confront. On the positive side, District staff and our Board leadership conducted encouraging discussions earlier this week with two independent bond rating agencies. Our District is currently rated AA by Standard & Poor's and Aa1 by Moody's Investors Service. In these discussions, the rating agencies were made aware of the District's adopted expenditure reduction plan; the voters' approval of Measure R and other parcel taxes and bond measures; the District's funding contract with the City of Santa Monica and continued financial support from the City of Malibu; sufficient general fund reserve levels for the 2010-11 fiscal year; and the general strength of our two communities' assessed value over the past ten years. We hope that Standard & Poor's and Moody's will re-affirm their positive ratings of our District by the end of June in preparation for a planned issuance in mid-July of the next series of Measure BB bonds.

But our State's projected \$19 billion budget deficit, combined with the voters' rejection in May of the Measure A school funding measure, means that further significant cuts to our local District budget are inevitable. Turning to our District's finances, we have been contacted by the Los Angeles County Office of Education, which performs mandated fiscal oversight of school districts for solvency. Jon London, a Business Services Consultant at the Los Angeles County Office of Education, has reviewed our Second Interim Report. Mr. London wrote a letter to the District on April 8, 2010 that raised three important concerns:

1. He noted that the District is continuing to project deficit spending and that "we are concerned that, if this deficit spending continues as projected, it will severely impact the District's fiscal solvency in future years."
2. Mr. London's letter also noted concerns that the District projects financial reserves that fall below the 3% level required by the State during the three year projection period. He noted that the District's reserves will be depleted completely and that the General Fund ending balance will decrease as a result of deficit spending.
3. The letter noted the risk to the District should it lose its appeal of the 2008-09 Audit Finding for attendance reporting at one of the District's middle schools, which could result in a \$5.8 million penalty and poses a further risk to the District's financial stability. The District has stated its belief to the County and to the California Department of Education that the ADA reported in 2008-09 was reasonable, even though it was not supported by all of the required documentation.

The County has requested that the Board approve a fiscal stabilization plan with revenue enhancements and/or expenditure reductions that projects reserve levels that do meet the 3% reserve level requirement. We believe that the adoption last week by the Board of the expenditure reduction plan satisfied the need for a fiscal stabilization plan for the next school year. But because of additional expected reductions to our state revenues for next year, Chief Financial Officer Jan Maez estimates that expenditure reductions in the range of \$4 - \$5 million must be made in 2011-12, and an *additional* \$3 million reduction must be made in the following fiscal year. Since the Fiscal Stabilization Plan will be due with the First Interim Report in December, the Board effectively has only about six months to develop and adopt a plan. I will discuss some of our recommendations to deal with these budget reductions and revenue enhancements later in this presentation.

Tonight's discussion is our third meeting in a workshop setting with the Board this year. The Board has conducted additional budget workshops before the public in special meetings that have been useful and productive. We have appreciated the Board's interest in grappling with our difficult fiscal predicament in a transparent and responsive manner. These workshops have proven to be useful for communicating information to the public, and provide opportunities for an open exchange of ideas about a complex subject. We on the FOC have of course 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.

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 2009-10.
2. Our report on Measure R expenditures during FY 2009-10 and 2010-11.
3. Comments on the current draft of the FY 2010-11 District budget.
4. Recommendations for the FOC to focus upon during 2010-11.

II. Summary of FOC's Activities During FY 2009-2010

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 2008-09 audit of District finances and Measure R expenditures. The auditor did identify certain deficiencies in internal controls over financial reporting that we monitored. In April we reviewed the auditor's update report concerning the previously unsatisfactory status of attendance reporting at one of the District's middle schools.
- Reviewed the 1st and 2nd Interim Reports, 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.
- Met with the Executive Director and board chair of the Santa Monica Malibu Education Foundation on several occasions to discuss fundraising goals for 2009-10.
- Analyzed the financial practices of numerous other school districts. We are paying close attention to how other leading school districts in California are handling the budget crisis, particularly with respect to expenditure reduction and revenue generation.
- Reviewed, discussed, and provided comments to the Board on a variety of other financial matters, including:
 - a) A review of numerous budget reduction proposals and adjustments to the District's financial position;
 - b) An update on the FOC's work concerning revenue enhancement opportunities for the District;
 - c) A discussion of the District's reserves for economic uncertainty, and projected reserve levels;
 - d) Comments on the 2008-09 audit findings;
 - e) A discussion of the Board's consideration of a marketing officer; and
 - f) A review of the 2010-11 budget development timeline.
- Through our Revenue Enhancement Subcommittee, we considered a large number of revenue enhancement options. We presented a set of initial findings in November for District-wide revenue enhancements which we will discuss later in this report. The Revenue Enhancement Subcommittee met with the District's Senior Cabinet about the proposals that were submitted in November.

- Through another 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.
- Given that most California school districts are facing difficult financial choices, we began to research alternative expenditure reduction and revenue enhancement approaches adopted by other districts that could be utilized by our District.

In addition, several of our members are active on other District committees, including the Parcel Tax Feasibility Committee and the Measure A Campaign Committee; the Measure BB Committee; the Special Education District Advisory Committee; the Strategic Plan Steering Committee; and the Superintendent's Advisory Committee on the Budget. This year, for the first time in many years, the Financial Oversight Committee experienced no turnover in our members.

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. 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. Once again, we also 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 fortunate to have active participation in our meetings by two sets of board liaisons. Our current board liaisons, José Escarce and Ralph Mechur, have provided us with valuable insights about board policy. Our previous board liaisons had also included Barry Snell, who still regularly attends our meetings and whose wise counsel we certainly value. Other members of the Board, such as Ben Allen, attend our monthly meetings as their schedules permit. Our meetings are open to the public and the press, and our agendas and minutes are posted on the Board's web site.

III. 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 2009-10. 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 2009-10 totaled approximately \$10.3 million and are shown below.

The Financial Oversight Committee reviewed the audit of Measure R that was performed by the District's auditors, Nigro Nigro & White for the FY ended June 30, 2009. This audit contained an unqualified, "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, 2010 will be reviewed by the FOC next year.

Santa Monica-Malibu Unified School District

Measure R Expenditures, FY 2009-10 and 2010-11

Category:	<u>FY 2009-10 Budget</u>		<u>FY 2010-11 Budget</u>	
	FTEs	Amount	FTEs	Amount
Measure R Revenues:		10,264,436		10,408,138
Measure R Expenditures:				
Physical Education Program	13.27	540,434	13.33	560,781
Technology	13.00	1,150,097	14.00	1,252,698
Art & Music Program	12.19	997,136	12.44	1,052,211
Library Program	18.38	1,139,368	10.38	764,876
Community Services	1.00	56,781	1.00	56,984
Administration Cost		13,043		13,251
Sub-total		3,896,859		3,700,801
District Program Preservation Due to Inadequate State Funding		6,367,577		6,707,337
TOTAL EXPENDITURES	57.83	10,264,436	51.15	10,408,138

Notes: 1. The Consumer Price Index - All Urban Consumers (CPI-U) has increased by 1.4%, so the Board of Education will consider an increase in the parcel tax to \$350.84 per parcel for 2010-11 (2009-10 level: \$346.00).
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 in inadequate state funding."

IV. Views on the Proposed FY 2010-2011 District Budget

The general financial context for considering the District's FY 2010-2011 budget remains difficult. The \$19 billion projected State deficit and the Legislature's budget debate that will take place this summer, forces all California school districts to plan for continued significant reductions in the years ahead. In the current statewide campaign environment, voters continue to signal to Sacramento that steep spending cuts are the 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 without making reductions in funding for K-12 education. The State's respected, nonpartisan Legislative Analyst Mac Taylor has told state legislators that he recommends that the state consider suspending Proposition 98 funding for schools, which could allow the legislature to reduce its commitment to K-12 education funding. 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 plus an additional 3.85% reduction in anticipated revenue limit funding. These budget deficits have been built into the District's most recent financial projections. We have already experienced a 20% reduction over the last two two years in many categorical program revenues. Whether the Legislature will accept the Governor's latest proposals is very much in question.

However, 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. To that end, the FOC applauds the District staff's continuing efforts to analyze opportunities for greater operating efficiencies, and the Board's support for expenditure reductions that correspond with the continued decline in state revenues. In light of our continuing state funding uncertainty, we support the Board's difficult decisions this year to adjust class sizes, to seek program efficiencies, and to commit to additional cost savings opportunities. We also urge the staff and the Board to continue your progress on developing appropriate staffing ratios in both 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 budget projection shows a deficit of about \$4.4 million in the next fiscal year alone, and a cumulative total deficit over the three-year projection period of \$18.7 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 repeatedly warned 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 are appreciative of the sacrifices agreed to by our bargaining units and by management in order to reduce our District's operating expenses. Through a combination of reductions in positions, furloughs, program consolidations and eliminations, and other measures, our District has reduced our expenses by \$15.8 million over the past three years. However, further significant decisions are required before the District is in a position to submit a budget that demonstrates the District's medium-term (3 year) financial solvency.

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 87% 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, additional years of furlough days, and/or changes in salaries and benefits will be a difficult set of discussions with the District's bargaining units. We note that with the failure of Measure A that the Board has the option to re-open labor negotiations with its bargaining units, and we support the Board's interest in pursuing additional flexibility. We also note that the bargaining units have given commitments to examine adjustments in benefits that could result in expenditure reductions as soon as January 2012. In order to resolve the ongoing projected budget deficit, everyone, including Management, will have to make sacrifices.

We note that there continue to be additional significant risks to the District's on-going fiscal stability in future years. For example, the Los Angeles Unified School District has previously announced its intention to withhold granting inter-district permits to resident students, which could affect as many as 1,200 of our District's students. While LAUSD did agree to rescind this decision for the 2010-11 fiscal year, there is no guarantee that the LAUSD's willingness to grant permits will extend past this next school year. The District must consider how it would cope with the potential loss of 10% of our students.

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. We will then be totally out of financial reserves. Thereafter, there will be a steady erosion of the unallocated fund balance at a rate of between \$4.5 million - \$7.5 million each year during the projection period. While our financial reserves have cushioned the impact of this erosion to date, it will be drawn down to zero in the coming year. What was a beginning balance of \$22 million at the start of this fiscal year is projected to be a fund balance of \$13 million in 2013. Let me be clear: even after the board's actions last week, our District remains on 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/or additional revenues. 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.

The federal stimulus dollars we have received were ear-marked for special purposes, and were a one-time event. We estimate that our District has received, over a two year period, an aggregate of \$7.5 million in federal stimulus dollars. Most of these funds were designated for special purposes, such as funds for Special Education and for Title I schools. These one-time funds have assisted 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. The use of these funds allowed us to postpone making some of the deep cuts that we had to make this year.

We need to again lay the groundwork for a more intensive budget process looking forward, since a fiscal stabilization plan detailing revenue enhancements and further expenditure reductions will need to be developed and adopted within the next six months. We call on the Board of Education to start the budget process for the 2011-12 fiscal year this summer with an examination of revenue enhancement opportunities and alternative delivery models for delivering a quality educational program for our students. Programmatic changes need time to develop, consider, and implement, and work on these should also commence immediately. As painful as it is to contemplate, a full range of budgetary solutions must be on the table for consideration, including even further increases to class sizes, administrative changes, possible school consolidations, programmatic reductions, and negotiated changes with our bargaining units. We ask that District Staff and the Board 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. Contingency planning, with consideration for how to strategically allocate additional revenues or make further expenditure reductions if required, should also be a prominent part of this process.

The District needs to focus upon revenue enhancement opportunities. My presentation tonight has primarily focused upon expenditure reduction, but I would now like to spend a few minutes focusing upon the strong potential our District also has for increasing our revenues. The FOC's revenue enhancement subcommittee has identified four high priority areas, which include the following:

1. **An aggressive attendance campaign.** While our District does experience high attendance, we have estimated that by implementing a District-wide attendance goal of 96% attendance, and by implementing an effective awareness campaign, that our District could garner as much as \$450,000 in additional revenues each year. Our understanding is that the District has agreed to undertake such a campaign for the coming year.
2. **Better utilization of District assets.** The District does own key sites in Barnum Hall and the Greek Theater which, with an up-front capital investment aimed at renovating these facilities, could yield significant additional annual revenues of

up to \$1 million/year. These projects are included in the planning for the Santa Monica Civic Center Joint Use Plan. Our thought is that because of their revenue generating potential, the renovations should be accelerated.

3. **Targeted fundraising.** Our Revenue Enhancement subcommittee has spent months examining effective District-wide fundraising practices, such as aggressive annual giving campaigns and alumni fund-raising, that are in place in other California school districts. We have held several conversations with the Santa Monica Malibu Education Foundation's Executive Director, Linda Gross, and her board members, who are enthusiastic about the District's fundraising potential but have said they have limited capacity with their current resources for additional new activities. We believe that the District should be capable of generating far more, as much as 10 times more, than it currently does in District-wide fundraising. Our District's fundraising should be a partnership, joining forces with parents, PTAs, booster clubs, principals, teachers, students, businesses, and our extended communities to make our schools the best they can be. Among the subjects we should discuss with our top donors is naming rights on buildings and venues. We have identified other attractive fundraising models which are reliably generating \$2 million - \$4 million in annual giving. We want to make clear that it is not only policy changes that make these efforts in other Districts successful, it is a combination of fundraising strategy, experienced resources, donor relationship cultivation, and sustained campaigns. An investment in a top development officer, along with staff support and a communications budget, at a minimum, is needed to generate the revenue level that we seek. To be successful at Districtwide fundraising we need to cultivate long-term relationships, approach and recognize our generous donors appropriately over time, and ask that our District's generous families support our District's excellent, but threatened, educational program.
4. **Generate licensing fees.** We have studied the work done for the Beverly Hills Unified School District, which is exploring a clothing and merchandise licensing deal with an outside vendor. We believe that we have a similar brand opportunity in our "Santa Monica High" and "Malibu High" names. We estimate that the District could expect to raise \$300,000 in the program's first year, with a potential \$1.5 million in revenue over three years. While there are some legal expenses, there are no up front fees for the licensee under this proposal.

Another important process that our District needs to complete over the next several months is the development of our strategic plan. The FOC is supportive of the strategic plan process, which has solicited input from a wide range of community constituencies about key priorities and direction. In this difficult financial 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, especially now when the need is so dire and the community is so motivated to support us.

V. Proposed FOC Focus for FY 2010-11

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 May 11, the Financial Oversight Committee decided to bring forward three specific topics that we would like to concentrate on during the next school year.

1. *Refine specific revenue enhancement recommendations.* The FOC's subcommittee on revenue enhancement has put forward recommendations on particular revenue generation opportunities for the District. We propose to turn our focus to the development of several concrete, high-priority proposals that we would like to bring to you for your consideration. We anticipate that areas of interest include the improvement of our District-wide fundraising capacity and practices generally, establishing new corporate partnerships, pursuing naming rights on buildings, merchandising opportunities, and so on. We would like to focus on those ideas that have the most promise, and continue our dialogue with you on actions needed to ensure the financial health of our District.
2. *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 service using the resources we already have.

3. *Continue to Analyze Financial Practices in Other Targeted School Districts, for Ideas that Could Be Implemented in the District.* Over the course of the spring, Financial Oversight Committee members each analyzed the financial practices of other leading California school districts for practical ideas that could be implemented by our District. We would like to include this analysis as an area of focus by our Committee for next year, and to bring to you particular approaches used by other Districts that could result in either significant cost savings or in significant additional revenues.

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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.