

December 14, 2009

Board of Education  
Hilliard City School District

Dear Board Members:

This is the second report by the Audit and Accountability Committee. In this report we will discuss:

- Assessment of the 2007 and 2008 State Auditor's Report and Management Letters
- Benchmarking Analysis of Costs
- Assessment of the 2009 Five Year Forecast

Once again we would like to thank the Board and the Administration for their assistance in providing unfettered access to Board records and meeting with us on numerous occasions.

**Assessment of 2007 & 2008 State Auditor's Reports and Management Letters**

The Audit and Accountability Committee (Committee) reviewed the fiscal 2007 and fiscal 2008 audit reports issued by the State Auditor's office as well as the management letters presented to the Board. The objective of the review was to determine if the school district addressed the deficiencies noted in the audit report and the suggested improvements noted in the management letters. It is important to note that the school district is required to address deficiencies noted in the audit report but the items noted in the management letters are suggestions for improvement.

There was one deficiency noted in the 2007 audit report regarding financial reporting. The Auditor recommended the District implement additional procedures to provide assurance over the completeness and accuracy of financial information within the CAFR (Comprehensive Annual Financial Report). The Auditor felt the finding was partially corrected when they reviewed the issue again in 2008 but noted there were still some weaknesses in the process. The Treasurer provided the revised policies and procedures to the Committee. Several members of the Committee reviewed the revised policies and procedures and found they appear to address the issue noted in the audit report and management letter. According to the Treasurer, the partial correction that resulted in a management comment in 2008 pertained to the State Auditor's office interpretation of SAS 112. The Auditor of State's interpretation of the standard requires a comment for any financial error regardless of materiality. The District has controls in place to provide assurance that financial transactions are posted and reported appropriately.

The suggestions for improvement noted in the 2007 and 2008 management letters pertained to interest earned on federal funds, review of the Federal Excluded Parties List System before awarding a contract that involves federal funds, expenditures exceeding appropriations, amended official certificate from the Budget Commission, student activities funds, and food service. The documentation provided by the Treasurer appears to address all of the concerns noted by the State Auditor's office; however, the Committee had additional suggestions to improve the internal controls surrounding the student activities funds and the food service operation.

The current process in place for the student activities fund requires the student activities advisor to collect the money for any fundraisers/sales and reconcile the deposits. There is no secondary review by an independent party to validate the money collected and deposited. The Committee suggested the District add a monthly review of one to two student activity funds per building in order to provide an independent review element to the process. The Committee further suggested that the review be random and rotate through all of the funds during the school year. It is important to note that the Auditor did not suggest any misappropriation of funds. The suggestions for improvement by the Committee were strictly to provide independence in the review and improve the internal controls of the current process.

The current process in place for the food service operation involved reconciling deposits for the entire building instead of by individual cashiers. The current process does not allow food service management the ability to identify which cashier was out of balance if there was a shortage found. There were several system issues noted with the point of sale (POS) system that did not allow individual cash till reconciliations. Discussions between the Committee and the Treasurer along with an update to the current POS system resulted in the process being improved and reconciliation at the individual cashier level to be implemented by the food service vendor. The food service vendor migrated to a blind balancing at the individual cashier level as of September 30th. Again, it is important to note that the Auditor found no indication of misappropriation of funds. The suggestions for improvement by the Committee were strictly to provide accountability for any shortages at the cashier level.

It appears from the information provided to the Committee that the District is appropriately taking action to correct any deficiencies noted by the State Auditor's office and implementing, where practical, the suggestions for improvement in the current processes noted by the Auditor.

### **Benchmarking Analysis**

In its May 2009 report the Committee compared HCSD operating costs and several other attributes to several local districts which had received an Excellent with Distinction rating. For this report the Committee took a little more in depth review of HCSD operating costs.

The State of Ohio mandates the use of a proprietary software system for all school districts in the state. The advantage of this mandate is that it enables the comparison of school data since the software and chart of accounts is identical for each district. Furthermore, the State uses the financial data from this database, along with census, tax and other data to prepare Peer Group comparisons. The State has classified each district into a Peer Group using a sophisticated algorithm which compares common attributes such as average daily membership (ADM or student population), district poverty count; the percent of households with professional or managerial positions; population; median and average incomes; percent residential, commercial and agricultural property; rural, urban or suburban location; etc. Hilliard is placed in a Peer Group that has an average ADM of about 8100 students compared to Hilliard's 14,000 students. Hilliard is the second largest of the 21 districts, the smallest of which has 4100 students at Perrysburg. Using 2008 data from the State, the cost per ADM for Hilliard was \$10,296 compared to \$9,698 for the Peer Group. Thus Hilliard cost per ADM is 6.2% higher than this Peer Group.

A better comparison we thought was to use a subset of the districts in the Peer Group that are located in greater Columbus. This includes Dublin, Gahanna, Pickerington, Westerville, and Worthington – all of which have received an Excellent w/ Distinction in 2008-2009 except Gahanna (Effective) and Westerville (Excellent). Not only are these districts included in Hilliard's Peer Group, they have similar geographic focus and most have a similar report card to Hilliard. Additionally, this subset of six districts was more manageable from a data presentation perspective than the 21 districts in the Peer Group.

The benchmarking of cost per ADM by Functional Areas helps to answer questions about how costs are spent (administrative vs. instructional, etc.). Appendix A shows how Hilliard's cost per ADM compares to the average of the six local comparison districts as well as the highest and lowest data points and the ranking from 1 (highest) to 6. The most notable conclusions from this data are that Hilliard's Administrative costs are the lowest of the 6 local districts, Instructional costs are the 2nd highest of the 6 districts and overall costs are 3rd highest.

Appendix B shows the costs per ADM by Object Code such as personnel costs and benefits. In this comparison Hilliard's personnel costs are 4th highest and benefits are 3rd highest. While we do not have underlying benefit cost data for the other local districts, it is reasonable to assume that the higher benefits costs are largely due to health care insurance as the other major benefit component (pension) is the same for all districts, and the remaining components are relatively minor (life insurance, disability, etc.). It should be noted that the total cost per ADM by Object Code only includes general fund costs and excludes most other fund costs which are included in the ADM by Functional Area, hence the difference in the \$10,968 (Functional Area) and \$10,296 (Object Code).

Appendix C shows the cumulative annual growth rate (CAGR) for costs per ADM for each of the local comparison districts from 1995 to 2008. This cost trend is worrisome in that Hilliard has the fastest growing costs per ADM of all 6 local districts in this 13-year period. Hilliard's costs have risen on average 5.8% every year in that period when the average for the other 5 districts is 4.8%. Further, the Consumer Price Index – Urban (CPI-U) has only increased 2.5% annually in the same period. Lastly, it should be noted that for the year ended June 2009 the same CPI decreased 1.7%.

Appendix D shows a comparison of teacher pay to teacher experience. It appears that the average teacher salary and the experience level are within the range of the other local districts. This is shown in the salary and experience rankings being similar, 4th and 3rd, respectively. Perhaps more significant is the level of fringe benefits as a percent of total costs per ADM (22%) is tied with the highest in the local comparison group. As mentioned above, a significant amount of these costs are identical on a percentage of salary between districts (pension costs).

In conclusion, on a cost per ADM basis Hilliard is about 6% higher than the state Peer Group but in the middle of the 6 local district comparison. Administrative costs are the lowest of 6 local districts but Instructional costs are 2nd highest. Most concerning is the fact that Hilliard's growth in spending from 1995 to 2008 is the highest among the 6 local districts. The reason(s) for spending per ADM outrunning inflation by approximately double the CPI (both Hilliard and the other 5 local districts) is debatable and not within the scope of this report.

## **2009 Assessment of Five Year Forecast**

### **Methodology**

At the submission of its initial report to the Hilliard School District Board of Education, the Audit and Accountability Committee detailed a six-month work-plan. Amongst the goals was an assessment of the five-year forecast, with a focus on the assumptions on which the forecast is based.

### **State Requirement**

State law requires (5705.391 of the Ohio Revised Code) that each school district prepare a five-year forecast. According to the Ohio Revised code, the purpose of the forecast is “for the auditor of state or the department to examine the five-year projections and to determine whether any further fiscal analysis is needed to ascertain whether a district has the potential to incur a deficit during the first three years of the five-year period.”

Additionally, the law requires that if a school district is going to incur a deficit, then the local school district must be notified. The local school district must act to prevent deficits in the current year and plan to eliminate deficits in future years, in response to this notification. In late November, the Ohio Department of Education notified the Hilliard School District that they have a deficit in the next three years.

Finally, the same statute lays out penalties for failure to comply. It also lists possible sanctions for anyone who willfully creates inaccurate data.

### **Model Results**

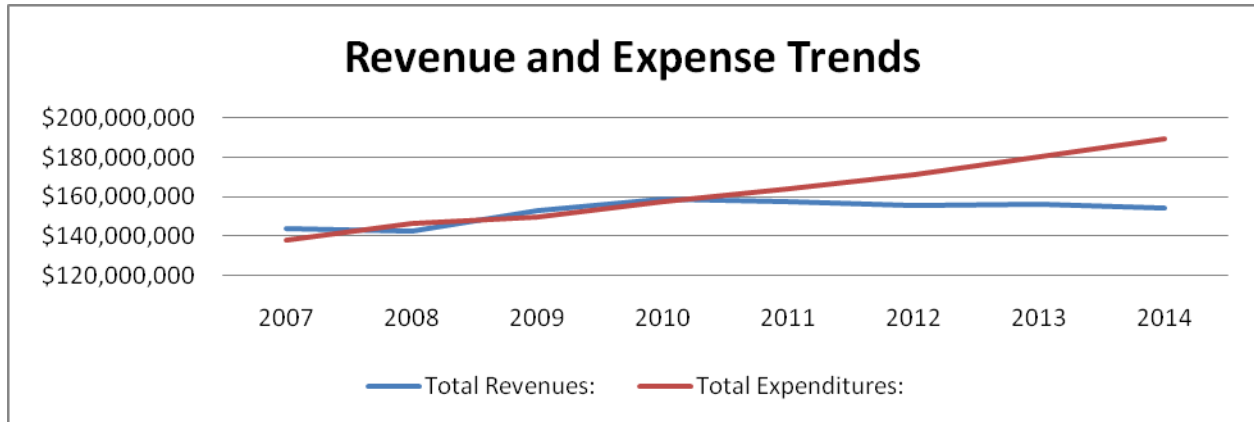
The forecast is published in a document by the Hilliard School District. It shows expenses growing in excess of revenues almost immediately and a deficit fund balance by the fiscal year 2012. The model and its associated trend-lines can be seen below.

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Total Revenues and OFS	\$ 144	\$ 143	\$ 153	\$ 159	\$ 157	\$ 156	\$ 156	\$ 154
Total Expenditures and OFS:	<u>139</u>	<u>146</u>	<u>150</u>	<u>158</u>	<u>164</u>	<u>171</u>	<u>180</u>	<u>190</u>
Excess (Deficit)	\$ 6	\$ (4)	\$ 4	\$ 1	\$ (6)	\$ (16)	\$ (24)	\$ (35)
Cash Balance:	\$ 17	\$ 13	\$ 17	\$ 18	\$ 12	\$ (4)	\$ (28)	\$ (63)
Estimated Encumbrances:	<u>2</u>	<u>2</u>	<u>3</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Fund Balance:	\$ 15	\$ 12	\$ 14	\$ 16	\$ 10	\$ (5)	\$ (29)	\$ (65)

**Table 1 - HCSO Five-Year Forecast, Summarized. Values are in millions.**

The average annual growth rate for all revenues is positive, when measured from 2007 to 2014. However, during the critical growth period of the forecast (2010 – 2014) real revenues are predicted to shrink, while during the same period of time, expenses are predicted to grow twenty-

percent. This discrepancy is primarily associated with the lack of any future levy and continued growth in wages and benefits beyond the known contract years.



### **The Forecasting Model**

The forecasting model is an Excel © spreadsheet. It is a professionally developed model by Robert W. Baird & Co., made exclusively for school districts to create forecasts. The model is meant to report in a fashion consistent with state requirements and accounting convention. Baird & Co. representatives regularly provide educational seminars on school-district financial management, including financial forecasting. The model is provided free of charge to participants of those educational sessions. It is used by many districts across the state.

The model appears to be comprehensive. Each line item has a tab showing the development of the related assumptions. Each assumption tab includes areas in which input can be entered for historical periods. Idiosyncratic calculations associated with education are often directly modeled with the formulas and input areas already working, waiting input. Graphs showing average historical trends compared to forecast periods are provided. Additionally, each detailed input in the creation of the summarized line item includes a separate area to document other assumptions or detailed calculations.

The Hilliard City School District Treasurer makes extensive use of the model, including development of “what-if” scenarios that are typically saved to the side of the main model. These scenarios are not intended to be published, but rather are part of the model development process. Many of the assumptions that are part of the detail which make up the forecasted line items do not have sufficient detail to understand without additional dialog with the Treasurer. This represents an opportunity for improvement. Some aspects of the model could not be reviewed as the spreadsheet is password protected and some formulas are not visible. Additionally, the protection made it impossible to include sample printouts within the electronic version of this document, since it does not allow copying of the output electronically. Robert Baird & Co address this within their notes, stating that their intention is not to prevent the deciphering of their formulas, but rather to protect the model from inadvertent errors through accidental keying and over writing of formulas.

We believe the model is sound, though there are some minor formula errors. This is common with any software and it appears in one case, the Treasurer notes the error and corrects the input to adjust for the model's deficiency.

**Forecast Assumptions**

Extensive notes on the assumptions are included within the published forecast. A comparison was made of each published assumption within the notes to the actual input (assumptions) in the spreadsheet. The Committee created a separate model, summarizing the forecast and verified the calculations. Comparisons were made on the change by line item in the forecast for each year. Additionally, change in revenue line items as a portion of total revenue and change in expenditure line items as a portion of total expenditures were calculated. The results of these calculations were compared against the inputs on the model and the notes.

**Revenue Assumptions:**

**Assumptions**

Revenues:	2008	2009	2010	2011	2012	2013	2014	Consistent with Notes
General Property Tax (Real Estate)	-2%	15%	10%	0%	1%	1%	1%	yes
Tangible Personal Property Tax	-22%	-12%	-52%	-5%	-5%	0%	0%	yes
Unrestricted Grants-in-Aid	-1%	0%	-7%	-4%	0%	0%	7%	yes
Restricted Grants-in-Aid	-8%	30%	728%	21%	-98%	1%	1%	yes
Property Tax Allocation	24%	27%	19%	1%	0%	-2%	-25%	no <sup>1</sup>
All Other Revenues	9%	-30%	-24%	-7%	0%	0%	0%	no <sup>2</sup>
Total Revenues:	-1%	7%	3%	-1%	-1%	0%	-1%	

<sup>1</sup> Source of reductions in 2013 and 2014 are not disclosed

<sup>2</sup> Listing of components to All Other Revenues not complete in notes.

## **Evaluation**

A summary of the assumptions, provided in the notes to the forecast and the evaluation of the Audit and Accountability Committee are provided below in bullet form.

### **Assumption**

- General Property Tax: Slow growth in commercial and private real-estate taxes and flat collection rates below 100% of taxes make up the largest revenue source.
- Unrestricted Grants-in-Aid: Shrinking state aid due to lower state revenues – worst case scenario.
- Restricted Grants-in-Aid: Loss of stimulus dollars with no backfill.
- Property Tax Allocation: Property tax reduction and homestead act reduce property taxes up to 12.5% with the loss of state replacement revenues.

### **Evaluation**

- The revenue assumptions are conservative. Some details of calculations are not disclosed in notes (i.e. detail of a component of “All Other Revenue”).
- Real-Estate (residential and commercial) as well as tax collection-rates are based on estimates from the county auditor and the experience of the treasurer. Future years appear conservative.
- Treasurer notes that state funding is a “worst case scenario.”

## Expenditure Assumptions

### Assumptions

Expenditures:	2008	2009	2010	2011	2012	2013	2014	Consistent with Notes
Personal Services	5%	2%	4%	4%	4%	5%	5%	no <sup>3</sup>
Employees Retirement / Benefits	10%	1%	5%	8%	8%	8%	8%	yes
Purchased Services	7%	12%	5%	3%	3%	3%	3%	yes
Supplies and Materials	6%	-21%	54%	-20%	2%	2%	2%	yes <sup>4</sup>
Capital Outlay	-41%	-23%	2%	2%	2%	2%	2%	yes
Principal (History)	0%	0%	-100%					yes
Principal HB263 Loans				0%	-100%			yes
Interest	-28%	-29%	-40%	-67%	-100%			yes
Other Objects	2%	9%	3%	2%	2%	2%	0%	yes
Total Expenditures:	6%	2%	5%	4%	5%	5%	5%	

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<sup>3</sup> Includes estimates for un-negotiated future contracts with no offsetting revenues for the same years; growth in staff of \$500K attributed to Bradley in year one, repeats in future years with no disclosure, possibly contradicts other assumptions on student population; movement of teachers between training categories (Bachelors, Masters, Ph.D. of \$120K per year not disclosed.

<sup>4</sup> Volatility related to textbook purchases.

## **Evaluation**

Team analysis and review of expenditure assumptions are provided in bullet form for brevity.

### **Assumptions**

- Personal services (salaries: Increases for contract required step-increases (2.3% per year) and cost-of-living wage increases, with some growth for Bradley in year one and others in future years (\$500K).
- Health insurance premiums growing in double-digits, offset by constant percentage of salaries to all other benefits.
- Low percentage of growth for purchased services and supplies (3% and 2% respectively).
- Capital outlays moved into a different fund.

### **Evaluation**

- Growth in expenditures are close to likely outcomes.
- Some differences between model's assumptions about annual increases and Treasurer's notes.
- Assumptions about contracts which are not negotiated growing expenses but no matching prediction about future revenue (levy).
- Basis for \$500K increase in staff at Bradley unclear in notes or model (how many staff members, what types, etc.).
- Purchase service growth rate is much lower than historical periods – may be too optimistic, the Treasurer discloses this.
- Supply cost volatility is tied to textbook adoption and Bradley start-up. Two percent growth rate appears reasonable.
- Capital outlays drop from historical periods due to a change in which fund is used.

### **Conclusions:**

The Audit and Accountability Committee was impressed with the overall model. By using a tool common to other districts it allows for the accumulation and dissemination of expertise and knowledge on the use of the tool. Emergent issues in financial modeling, such as the accounting for federal stimulus dollars can be discussed with peers and colleagues across the state and consensus methods and presentation can be developed. The mechanical rigor of the model is sound.

The Audit and Accountability Committee believes that the Five-Year Forecast developed by the HCSD administration is adequate for identifying the next likely period in which a levy will be necessary to augment the current run-rate of expenses. The conservative bias (assumptions of low growth in revenues and high growth for expenses) makes the likelihood of the financial results being negative relative to expectation extremely low.

The opportunities for improvement exist primarily in the following areas: The notes for the forecast are written in a fashion which makes them difficult for non-financial professionals to decipher. The Committee membership is dominated by financial professionals and cumulatively, it took the group many hours to decode the notes and compare them to the underlying model. Because the Five-Year Forecast is a public document, the Committee believes that the notes should be written so that a general member of the public can read the note and clearly understand the intention of the communication. There are no assumptions that cannot be clearly described. Additionally, the notes are not comprehensive. There are several examples where there are material assumptions within the forecast itself but without disclosure in the notes. The Committee believes the missing disclosures are simply an oversight, since the Treasurer readily shares the underlying model, including his detail notes on its development with requesting members of the public.

The largest area of concern of the Committee was the five-year trend, indeed, the ten-year trend when including historical years, showing an expense growth rate well in excess of revenues. This concerns the Committee because it means that increasing property taxes every few years is the only way to sustain the existing services. This would mean that taxpayers within the Hilliard City School District would have to dedicate ever-larger portions of their income on real estate taxes to maintain current school district services.

It is beyond the scope of the Audit and Accountability Committee to make specific recommendations on how to bring revenue and expenses in line. However, the Committee does believe that some combination of “top-line” or revenue management and expense growth reduction is inevitable in the future.

As always, we encourage the Board to share these and future findings with the community-at-large and are willing to accept questions and feedback from the board or the members of the community.

Yours Truly,

The Audit and Accountability Committee,<sup>2</sup>  
Board of Education,<sup>2</sup>  
Hilliard City School District  
Don Bell, Terri Berchak, Les Carrier, Shawn Hiller, Nathan Painter, Ed Sarkel, <sup>2</sup>Mike Stoner,  
Nathan VanLaningham

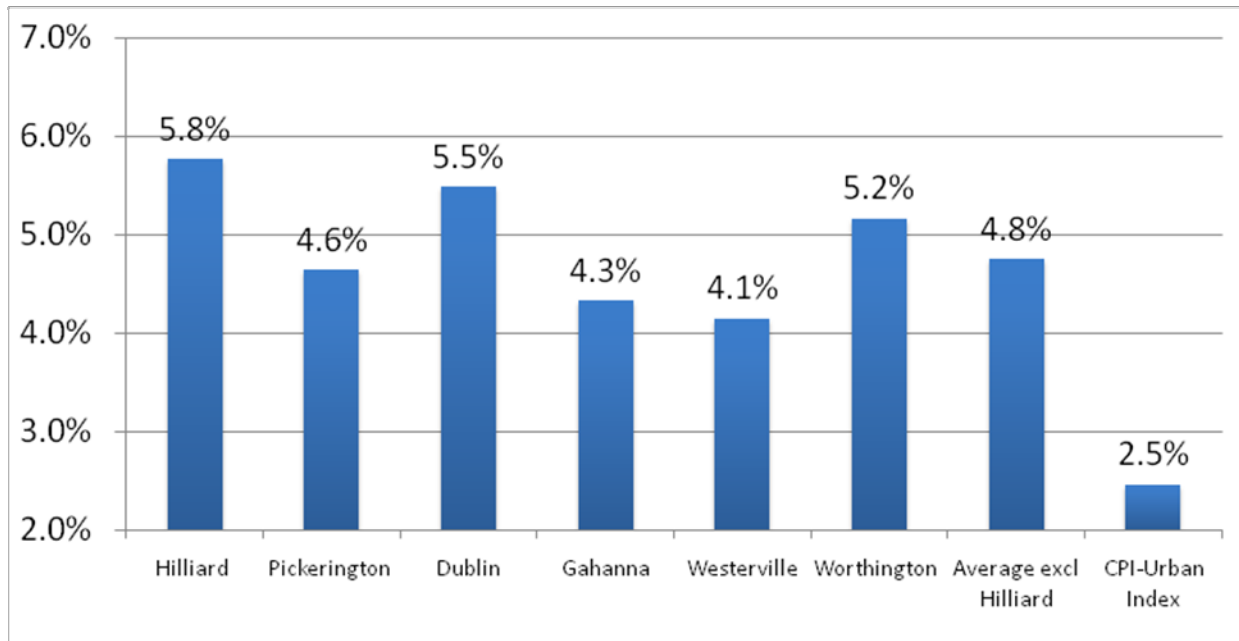
## Benchmarking Local Comparisons By Functional Area per ADM (2007-2008)

Area	Hilliard	Average	Max	Min	(Highest = 1) Hilliard Rank
Admin	1,002	1,177	1,564	1,002	6
Instructional	6,685	6,325	7,128	5,368	2
Staff Support	390	314	610	152	2
Building Operations	1,744	1,830	2,018	1,673	4
Pupil Support	1,147	1,169	1,439	879	3
Total	10,968	10,815	12,301	9,299	3

## Benchmarking Local Comparisons By Object Code per ADM (2007-2008)

	Hilliard	Average	Max	Min	(Highest = 1) Hilliard Rank
<b>Personnel Services</b>	6,736	6,968	7,905	5,667	4
<b>Benefits</b>	2,296	2,185	2,731	1,951	3
<b>Subtotal Personnel Comp.</b>	9,032	9,153	10,598	7,636	4
<b>Purchased Services</b>	689	1,089	1,329	596	5
<b>Supplies &amp; Materials</b>	315	280	345	249	2
<b>Capital Outlay</b>	14	79	207	14	6
<b>Other Projects</b>	245	212	295	171	2
<b>Total</b>	10,296	10,812	12,078	9,516	4
<b>Personnel compensation %</b>	87.7%	84.4%	90.1%	80.2%	3

# Cost / ADM:CAGR FY 95 - 08



# Teacher Pay vs. Experience 2008-2009

District Name	Average teacher salary	Average Years of teacher experience	Fringe Benefits as % of Expenditures	Average Salary Rank	Teacher Experience Rank
Hilliard	64,703	14	22%	4	3
Dublin	66,885	13	20%	3	5
Pickerington	60,933	11	21%	6	6
Gahanna	67,494	16	18%	2	2
Westerville	63,995	14	19%	5	3
Worthington	68,355	18	22%	1	1