

February 14, 2011

Board of Education
Hilliard City School District

Dear Board Members:

This is the fourth report by the Audit and Accountability Committee (“Committee”). In this report we will discuss:

- Assessment of the 2010 State Auditor’s Report and Management Letters
- Financial Summary Compared: Fiscal 2008 to Fiscal 2011
- 2010 Five-Year Forecast – Review and Recommendation

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. Throughout the remainder of this report we will use both “HCS D” and “the District” to refer to the Hilliard City School District.

Assessment of 2010 State Auditor’s Report and Management Letter

Members of the Audit Committee reviewed the Audit Report for the June 30, 2010 financial statements and the Management Letter, both dated October 25, 2010. The objective of the review was to determine if the District addressed any deficiencies, if any, noted in the audit report and the suggested improvements noted in the management letters. It is important to note that the District is required to address deficiencies noted in the audit report but the items noted in the management letters are suggestions for improvement, not requirements. The Auditor of State issued an unqualified opinion on the 2010 financial statements, during their audit they noted no deficiencies in internal controls and the Management Letter had only one comment that has been corrected.

Additionally, the Committee met with a representative of the Auditor of State’s office to discuss the audit and to inquire if there were any issues that the Committee should be aware of. The auditor was very complimentary toward Brian and his staff and said there were no issues noted during the audit.

Finance Summary Compared: Fiscal 2008 to Fiscal 2011

In November 2008, 53% of the Hilliard School District voters approved a 6.9 mill levy that was estimated to raise about \$16.3 million in additional taxes annually. The Administration estimated that this new level of millage would provide adequate resources for two years if spending cuts were made throughout the District. In the fall of 2010 the Administration announced that a levy would not be placed on the ballot until May 2011. In effect the 2008 levy was stretched for another year as a result of personnel reductions made in both FY 2009 and FY 2011 and by reducing the rate of growth of health insurance costs as a result of the change to self-insurance and having employees contribute a portion of their health insurance premiums.

The Committee thought it would be helpful to compare the finances from fiscal 2008 (the year of the last levy) to fiscal 2011 (Budget). Please note that the District's fiscal year ends June 30, thus fiscal 2011 runs from July 2010 until June 2011.

Schedule A shows the sources and uses of funds that are discussed below.

Revenues:

Real Estate Taxes increased from \$71.7 million in 2008 to an estimated \$90.2 million for 2011 or 25.8%. The \$18.5 million increase in real estate taxes is primarily the result of the 6.9 mill levy voted in 2008 that was collected from 2009 onward. The variance between the \$18.5 million and the estimated raise of \$16.3 million noted above is due to new property built in the District and property reappraisals.

Tangible Personal Property Taxes changed from \$9.6 million in 2008 to \$3.8 million per the 2011 budget representing a 60.2% decrease. The decrease is mainly due to the elimination of the personal tangible property taxes resulting from changes in Ohio law. The state provides all districts with supplemental funds to offset the decrease in the personal tangible property taxes, of which Hilliard received \$12 million in FY 2011. However, that supplement will decrease by \$5.6 million in FY14 and be phased out in 2017. This is one of the major losses of revenue for the district since the last levy was passed.

Unrestricted Grants (state aid) decreased \$3.4 million or 9.2% in the three years. Restricted Grants represent federal aid that is designated for specified programs has increased by \$2.4 million as a result of the various Federal stimulus programs announced in 2009. Property Tax Allocations represent monies provided by the State to reimburse districts for local property taxes reduced by the State via the Homestead and Rollback initiatives that increased \$7.5 million or 51.9%. In total, these grants increased from \$52.1 million in 2008 to \$58.6 million or 12.4%.

Other includes tuition, interest income, class fees, and compensation for tax abatement. It decreased from \$9.3 million in 2008 to an estimated \$3.9 million for 2011, or 57.9%. Lower interest income is the largest component and is the result of lower cash balances and lower interest rates.

In summary, revenues increased from \$142.8 million for 2008 to an estimated \$156.6 million for 2011, or 9.7%. The proportion of funding provided by the State remained unchanged at 37%, however, the proportion from local taxpayers increased 3 percentage points to 60%.

Expenses:

Salaries and Benefits changed from \$128.4 million in 2008 to a budgeted \$142.4 million for 2011 representing a 10.9% increase. Salaries and Benefits as a percentage of total spending changed from 87.7% in 2008 to an estimated 87.9% for 2011. Not surprisingly, 89.6% of the increase in district spending during the time period is attributed to Salaries and Benefits.

Purchased Services changed from \$9.8 million in 2008 to an estimated \$11.3 million for 2011 which represents a 15.7% increase. The largest increases are due to utilities, charter school payments and Autism scholarship payments.

The Supplies and Materials and the Capital Outlay categories had small decreases in spending. Other expenses increased \$266 thousand due to increased costs of property tax collections and of the Win-Win Agreement.

Total expenses changed from \$146.4 million in 2008 to an estimated \$162.0 million for 2011 representing a 10.6% increase.

Percentage Changes from FY 2008 to FY 2011

Revenue	9.7%
Expenses	10.6%
CPI	(.5%)
Enrollment (ADM)	2.3%

2010 Five-Year Forecast – Review and Recommendation

State law (5705.391 of the Ohio Revised Code) requires 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.”

The forecasting model is an Excel© spreadsheet professionally developed by Robert W. Baird & Co. made exclusively for school districts to create forecasts. Because the model has already been previously reviewed and concluded as sound, this review will not focus on the model. Rather, focus will be on changes in assumptions and dollars from the prior-year forecast to the current forecast.

2011 Forecast Summary

(Dollars in thousands)

	2011	2012	2013	2014	2015
Total Revenues	\$156,556	\$154,632	\$154,183	\$151,508	\$153,250
Total Expenditures	161,966	166,682	175,949	183,279	191,289
(Deficit)	<u>\$(5,410)</u>	<u>\$(12,049)</u>	<u>\$(21,766)</u>	<u>\$(31,771)</u>	<u>\$(38,039)</u>
Assume Levy passage	-	7,700	15,400	15,400	15,400
Proforma (Deficit)	<u>\$(5,410)</u>	<u>\$(4,349)</u>	<u>\$(6,366)</u>	<u>\$(16,371)</u>	<u>\$(22,639)</u>
ADM (Enrollment)	15,503	15,658	15,814	15,972	16,132

The table above shows a summary of the latest forecast. Probably the most striking feature of the forecast is the size of the future deficits. Please note that State law prohibits the Treasurer from including revenues from any future levy. Remarkably total revenues actually decrease from 2011 to 2015 (assuming of course that the aforementioned assumptions are reasonably close) by about \$3 million. Unfortunately expenses increase nearly \$30 million over the same period. For the mathematically inclined, expenses are increasing at a compounded annual growth rate (CAGR) of about 4.2% while revenues are declining at .5% CAGR. Even if the levy passes, it would “only” raise a little over \$15 million annually. Thus, based on the assumptions the District would be deficit spending by 2013. In fact, 2011 would be a deficit as a 2011 levy will not be collected until calendar 2012. And 2012

would only include half of the new levy (in Jan – Jun 2012), thus it would be a deficit as well. Then, in 2013 the District is projected to spend more in that fiscal year than the new levy collects.

Revenues:

One of the biggest changes to the revenue assumptions is the assumption that residential / agricultural real estate appraisals will be lowered 8% in the 2011 reappraisal. This downward appraisal is based upon recent county auditor data that compares the prices of residential closings to their respective tax valuations. While the 8% decrease appears to be a solid assumption, there is no guarantee that the actual reappraisals will decrease 8%. Further, the reappraisals will only affect “inside millage” and recent levies that will not collect the maximum dollars permitted for that levy under House Bill 920. Additionally new property growth is assumed to increase at slightly slower rates than the assumption in the prior year forecast. The combined effect of these changes in assumptions is to lower future revenue from 2012 and thereafter by about \$1.2 million annually.

The other large assumption change is the use of a 10% decrease in 2012 School Foundation aid (State funding). This represents approximately \$3.5 million in lost funds from the State if the assumption becomes reality. This is the most uncertain of the assumptions in this forecast as it is a politically derived amount. Unfortunately the decrease could easily be more and we wonder if there is more downside than upside risk in this assumption. This is partially offset by an additional \$1.8 million will be received in Federal stimulus funding in 2012 as a result of the federal jobs stimulus bill passed in the last half of 2010.

Expenses:

There were no changes in assumptions between 2010 and 2011 in Personal Services that explain the increased costs in 2011 from the prior forecast. The change represents about a 1% variance attributable to a projection difference. Employee Benefits decreased as a result of lowering the assumed annual increases in health insurance from 10% to 8%. The insurance premium for the 1st half of calendar 2011 increased less than 5% and the administration is hopeful that wellness programs will save premiums since becoming recently self-insured. Purchased Services include utilities as well as payments to other public entities educating Hilliard students. The two significant changes in assumptions are a nearly \$400,000 reduction in natural gas charges in 2011 and future years, and a lowering of other Purchased Services increases in 2013 through 2015 from 3% to 2% annually. Enrollment in the 5 years is project to increase approximately 1% annually to 16,132 in 2015.

Conclusions:

In general, the forecast method, model and assumptions are considered valid, especially when used to identify the timing of a potential future levy. The improvement in each fiscal year is the result of expenditure savings larger than the reductions in revenue forecasts. As noted in the previous table the largest of the expenditure savings is due to changes in the health insurance assumptions that appear reasonable. It should be noted that the assumption regarding state funding cuts is very hard to estimate due to its nature. As mentioned earlier this number may have more downside than upside risk. More importantly, the 2011 forecast projects deficits that will not be erased, even with a new levy, without additional spending cuts than assumed herein.

Summary

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,
Board of Education,
Hilliard City School District

Don Bell, Terri Berchak, Les Carrier, Shawn Hiller, Nathan Painter, Ed Sarkel, Mike Stoner, Nathan VanLaningham