

June 16, 2010

Board of Education
Hilliard City School District

Dear Board Members:

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

- Assessment of the 2009 State Auditor’s Report and Management Letters
- Benchmarking Analysis of Costs - Update
- 2010 Five-Year Forecast – Review and Recommendation
- Strategic Performance Objectives and Measures
- Compensation Expense

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 2009 State Auditor’s Reports and Management Letters

At the time of our previous report, the Auditor of State was finalizing their 2009 audit of the District and did not have the final version of the audit report and management letters available. Members of the Audit Committee reviewed the Audit Report for the June 30, 2009 financial statements and the Management Letter, both dated October 30, 2009. 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 2009 financial statements, during their audit they noted no deficiencies in internal controls and the Management Letter had only two comments, one of which has been corrected:

- The Auditors indicated there were variances between the appropriations and the actual resources for seven different funds. Management explained that the issue related to the timing of the receipt of the funds as opposed to over appropriations of available revenue for any particular fund. This is a fairly common issue for school districts and the Committee does not believe this is a serious concern.
- The only other improvement recommended by the state auditors related to the food service cashier collection procedure. This comment was noted in the last Committee report to the Board and was subsequently corrected by the administration in September 2009; however, this was after the audit period covered by the state auditors. With the improvements to the cashier collection procedures, we do not expect this recommendation to be repeated.

Benchmarking Analysis of Costs – Update

The 2009 CUPP Report contains several positive aspects with respect to costs incurred by HCSD. Most notably, the average spending per student fell by 2.5% compared to fiscal 2008 (see Exhibit I). While the Average Daily Membership (ADM) for students enrolled in the District increased again, the increase was only 0.3% and does not materially affect the average spending per student. Indeed, HCSD cut costs in all major functional areas except administration spending. The slight increase in Administration spending per ADM is the result of wage and benefit increases as well as the hiring of the Bradley High School principal and his assistant in the year prior to the opening of Bradley. The decrease in total expenses was due to the elimination of 91 positions resulting in compensation savings of about \$3.5 million and the increase in employee contributions towards their healthcare insurance premiums that began in March 2008 (shortly before the beginning of fiscal 2009) resulting in additional savings of about \$1.0 million.

While the decrease in the 2009 cost per student may seem minimal, when compared to local peer districts the decrease in cost is significant. The costs per student rose among other peer districts between a range of 1.9% (Worthington) to 5.6% (Westerville). In fact, HCSD was the only district among its five peers to have a decrease in the cost per student.

Despite this positive report for 2009 there remains considerable concern over the long-term trends in the increase of costs incurred by the District. Over the last 14 years, costs have increased an average of 5.2% each year, or 114% since 1995 (Exhibit II). This rate is even more alarming given the fact that CPI (Consumer Price Index - Urban) has only increased 38% over the same time period. Indeed, the inflation index dropped 1.7% in fiscal year 2009. As shown in the District's 114% increase over the 14-year period compares with the peer group which had a range of 87% to 118%.

In conclusion, while the Audit and Accountability Committee commends the District for reducing costs per student for 2009, the past expense growth rate significantly above CPI rates is not sustainable. The District and community must remain cognizant, however, of the effect on the quality of education provided to students in taking any measures to reduce the growth in costs.

2010 Five-Year Forecast – Review and Recommendation

In Ohio all school districts are required to prepare and submit a five-year forecast twice each year. The most recent five-year forecast was issued in May 2010. In contrast to the forecast reviewed last fall, the Committee performed a less detailed review of this forecast and concentrated its efforts on understanding the newest assumptions and results. The assumptions are largely unchanged from the last forecast, with the following exceptions. Revenue has been decreased for assumed property value reappraisals (downward) by \$1.5 million and other revenue decreases of \$0.4 million. On the expense side, assumption changes include the elimination of positions in fiscal year 2011 amounting to \$1.2 million in savings, implementation of all day kindergarten in fiscal year 2013 costing \$1.3 million and an assumption that future labor contracts commencing in 2011 will have no cost of living raises over the next three years, but that step and educational increases will remain.

The resulting picture drawn by the forecast shows expenses growing while revenue decreases. Revenues are projected to **decrease** by 3.6% over the five-year period (a cumulative annual loss rate of .7%). On the other hand, future growth in expenses are expected to **increase** 14.4% over the five-year period (a cumulative annual growth rate of 3.2%) – a rate that continues to significantly exceed past revenue growth and greatly exceeds the expected revenue **losses**. This is a revenue-to-expense growth gap of 3.9 percentage points. The rate of growth in costs is simply not sustainable nor supported by current economic factors. We laud the Board, Administration and employees of the District who have helped it achieve Ohio’s rating of “Excellence with Distinction.” Nevertheless, this Committee urges the Board, Administration, and employees of HCSD to aggressively manage the cost profile of the District to a much slower and sustainable rate.

As this Committee’s understanding of the District’s financial situation and operating environment has evolved, it has become clear that a few strategic issues are looming. We have become increasingly concerned that the convergence of these issues may threaten the financial condition of the District and, hence, the quality of education provided to its students. Specifically, our concerns are (i) given the tepid national and local economic outlook, the projected expense growth of HCSD significantly exceeds the capacity for additional revenue funding by the District’s taxpayers; (ii) possible drastic cuts by the State of Ohio to meet an estimated \$8 billion budget deficit in its next biennial budget may significantly impact HCSD in a negative manner; and (iii) in the longer term, continued residential growth (and resulting student enrollment) in the District may be out of proportion with the new commercial property tax base needed to support it. If these issues converge unfavorably over the next two to five years, the incremental tax burden on HCSD taxpayers could become untenable, with drastic repercussions for HCSD students. Similarly, current economic conditions have raised these same issues for many other school districts across the region, state and country.

The Committee acknowledges that these issues are complex and include policy matters that should be tackled jointly by State and local political leaders, and education leaders. Considering the past “non-performance” by the State legislature regarding the equity of school funding in Ohio, we doubt that any innovative solutions will be put forth in the near future. Moreover, we fear that local taxpayers in Ohio will bear more of the financial funding of school districts as the State struggles with a languishing economy. We are concerned that taxpayers have been economically stressed due to higher unemployment, low income growth, reduction in property values, and lowered retirement savings values. Therefore, this Committee recommends and implores the Board, Administration, employees, and other stakeholders of HCSD to find a fair, effective, and permanent means of managing cost increases relative to HCSD taxpayer income.

Finally, the District and community must remain cognizant of the effect on the quality of education provided to students in taking any measures to reduce the growth in costs. We are not advocating for lowering the educational standards and relinquishing the District’s inclusion among the best performing school districts in the local area. We believe the educational performance of the students and District makes HCSD a valuable part of the communities in its boundaries.

Strategic Performance Objectives and Measures

All successful enterprises utilize strategic objectives to establish long-term direction and goals, and they relentlessly measure performance against those objectives. There is a saying... “What’s measured is what’s improved upon”. Having established the strategic issues in the prior section, we believe that consideration of strategic objectives and performance measures will be essential to the Board and HCSD stakeholders as long-term effective solutions are sought to managing cost increases.

In the course of its duties this Committee identified various documents highlighting educational objectives and performance. Indeed, HCSD has established and uses many strategic objectives and measures regarding the quality of education within the District. The Continuous Improvement Plan and the High School 2020 plan are comprehensive examples of the strategic objectives for the District’s endeavors regarding the quality of education. We understand that a similar plan is under development for K-8, and we applaud the District for its continued pursuit of educational excellence.

In a similar fashion, we believe that it is imperative for the Board to establish a consolidated view of the strategic objectives most important to the District and include them in a separate “board overview” section of the Continuous Improvement Plan. We recommend creation of a “dashboard” of 15-20 significant objectives and their respective measures. The dashboard should incorporate objectives and measures not only in educational, but in financial, operational, and other major areas of importance. (See Exhibit III for a table of possible metrics.)

We believe that many of these objectives and measures may already exist but require assembly and consideration in one location to bring focus on the issues most important to the Board and HCSD stakeholders as the District’s cost profile is managed prospectively. To that end, we recommend that the Board and Administration:

1. Establish (and/or formalize in one place) strategic objectives for guiding the leadership of HCSD over the next several years, and review and revise these annually
2. Develop performance measures that provide clear and meaningful feedback regarding performance toward each objective
3. Update actual results and forecasts for the measures frequently (i.e., the dashboard) to enable strategic responses to changing “business” conditions
4. Persistently communicate performance toward those objectives to HCSD stakeholders

It will take time and effort to establish, track, and report these strategies and measures, and they could expose vulnerabilities in District performance, which will create tension between HCSD and stakeholders until performance and conflicting expectations are resolved. But multiple benefits will arise from assembling, measuring, and communicating strategic objectives. Both short-term and long-term dividends will be realized, including:

- Focusing personnel on long-term plans for the benefit of the District’s education stakeholders
- Providing insight needed to adjust plans and tactics in response to shifting trends
- Establishing a base of information useful in planning and communication
- Clarifying accountability and performance in communications with stakeholders

- Building a track record of openness and attentiveness toward stakeholder objectives that bolsters community support
- Developing alternate scenarios that enable contingency planning

As noted in the No. 4 recommendation above, the Committee especially wants to emphasize the need for persistent communications. It is imperative that the public understand how its tax dollars are dedicated to education to: (i) equip students for successful college and vocational experiences; (ii) return value to the community; and (iii) compare with the performance of other districts. Without adequate communication to these stakeholders, the benefits of establishing and measuring strategic objectives will be diminished.

The information presented to the community through the Superintendent's message, "Board coffees," and the email/website system are valuable and effective for communication of certain messages. However, more channels of communication and public assessment must be opened up to ascertain that HCSD stakeholders are sufficiently engaged in the conversations about the District's strategic objectives. Published information should be very clear and graphic. Invasive communication may require non-traditional means of reaching the stakeholders in the community.

In summary, we do not believe that implementing these recommendations will be easy. Within the Committee, which by definition is comprised of members with financial, auditing, and legal acumen, we do not have the specific expertise to solve the problem of providing a quality education with highly limited and currently volatile funding. Nevertheless, we strongly believe that following best practices in target setting, planning and establishing accountability for results, as well as persistent, invasive communication, are paramount to solving the District's expense growth issue and avoiding future financial crises.

Compensation Expense

As we indicated in our previous report and again in this report, the current rate of expense increases is unsustainable. Salary and benefits for District employees account for **87.7%** of expenses. Although the District has delayed requesting a levy from the taxpayers by increasing bus route efficiencies and other worthwhile cost savings, it cannot make a significant impact on the budget without addressing the salary and benefits portion of the expenses. As mentioned earlier in this report, in 2009 the District was able to lower the cost per student from the 2008 level by cutting positions. Despite these reductions in costs, the raises mandated by contracts offset much of those savings.

Only 6.6% of the District wages are outside of the HEA and OAPSE contracts. As such, a significant portion of the upcoming expenses for the District will be determined when the two contracts are renegotiated this year, as both expire on December 31, 2010. The results of the contract negotiations will significantly affect the level of future tax levies required to maintain the current level of services and education for our children. Thus, it is important to discuss some of the elements that comprise the two contracts that will become an integral part of the upcoming negotiations. While not collectively negotiated, sometimes Administration salary increases or benefit provisions are similar to those negotiated with the unions. The following is presented not to advocate a position but to educate. The overriding point is that most of the District's costs are

related to these contract provisions and future contracts will very directly impact the size of future levies.

Raises

The general public understands the raises (“Cost of Living Adjustments”) negotiated for the last contract for both the HEA and OAPSE were 3% in 2008, 3% in 2009, and 3% in 2010. What the general public may not understand is the salary for a teacher with no experience and a bachelor’s degree in 2010 (\$38,362) is 9.3% higher than the same qualifications in 2007 (\$35,107) due to compounding.

Administration increases have averaged 3.9%, 3.0% and 2.5% for the three years ended 2010 (9.7% compounded).

Step & Educational Pay Increase

In addition to the “pay raise” agreed to by contract for HEA employees, HEA members, like most Ohio teachers, are eligible for “Step” increases as well as Educational Pay increases. HEA members receive a 4.15% Step increase over their base salary for each year of service for years 1-15 as well as for year 20 and year 23. In addition, HEA members receive a 6% increase over their base salary and Step increase for each level of education (Bachelors, Bachelors Plus, Masters, Masters Plus) they obtain. Therefore, our hypothetical teacher with a bachelor’s degree and no experience started earning \$35,107 would earn \$43,338 after 3 years or an increase of 23.4% or 7.3% compounded annually.

OAPSE members also receive step increases: 14 steps per position (one step per year). Each step provides an increase of between 1.2% and 1.8%. OAPSE members do not receive an educational pay increase but they do receive a longevity payment if they have 18 or more years of service, ranging from \$225 to \$350 annually.

Administrative employees do not have automatic step increases, educational pay increases or longevity payments, thus their average annual raises totaled 9.7% over the 3-year period.

Health Insurance

After salaries the most expensive compensation component offered to District employees over which the District has control is health insurance. Pension expense is another large benefit the cost of which is largely defined statutorily by the State. All HCSD employees received health insurance at no cost to them until the recent 2008-2010 contract. Under the current contracts, HEA and OAPSE members paid 6% of the premium cost in 2008, 8% in 2009, and 10% in 2010 with caps that gradually increased in 2010 to \$50.19/month for single and \$135.52/month for family coverage.

Administration employees paid 10% towards their premium cost for all three years with no cap.

The implementation of employee contributions to health insurance premiums saved the District about \$1 million in fiscal 2009 compared to fiscal 2008.

Summary

In summary, compensation expense is the driving force of education costs in all districts. In HCSD compensation currently comprises over 87% of total District expenses. While it is important that the Administration continually watch all costs, compensation expense for Administrators, teachers and support staff is the only expenditure that “moves the needle”. As the District works through the difficult economic circumstances and the strategic matters raised in this report, we recommend that all employees of the District participate in the development of solutions. Equitably sharing the duty of implementing solutions, financial and otherwise, will be important to community acceptance.

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

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HCSD Cost per ADM 2009 vs. 2008

	FY 2009	FY 2008	Var. (Unfav)	Var. %
Administration	\$1,017	\$1,002	\$(15)	(1.5%)
Instructional	6,456	6,685	229	3.4%
Staff Support	386	390	4	1.0%
Building Ops	1,725	1,744	19	1.1%
Pupil Support	1,113	1,147	34	3.0%
Total Cost / ADM	\$10,697	\$10,968	\$271	2.5%
Average Daily Membership	15,089	15,048	(41)	(.3%)

Cost / ADM:CAGR FY 95 - 09

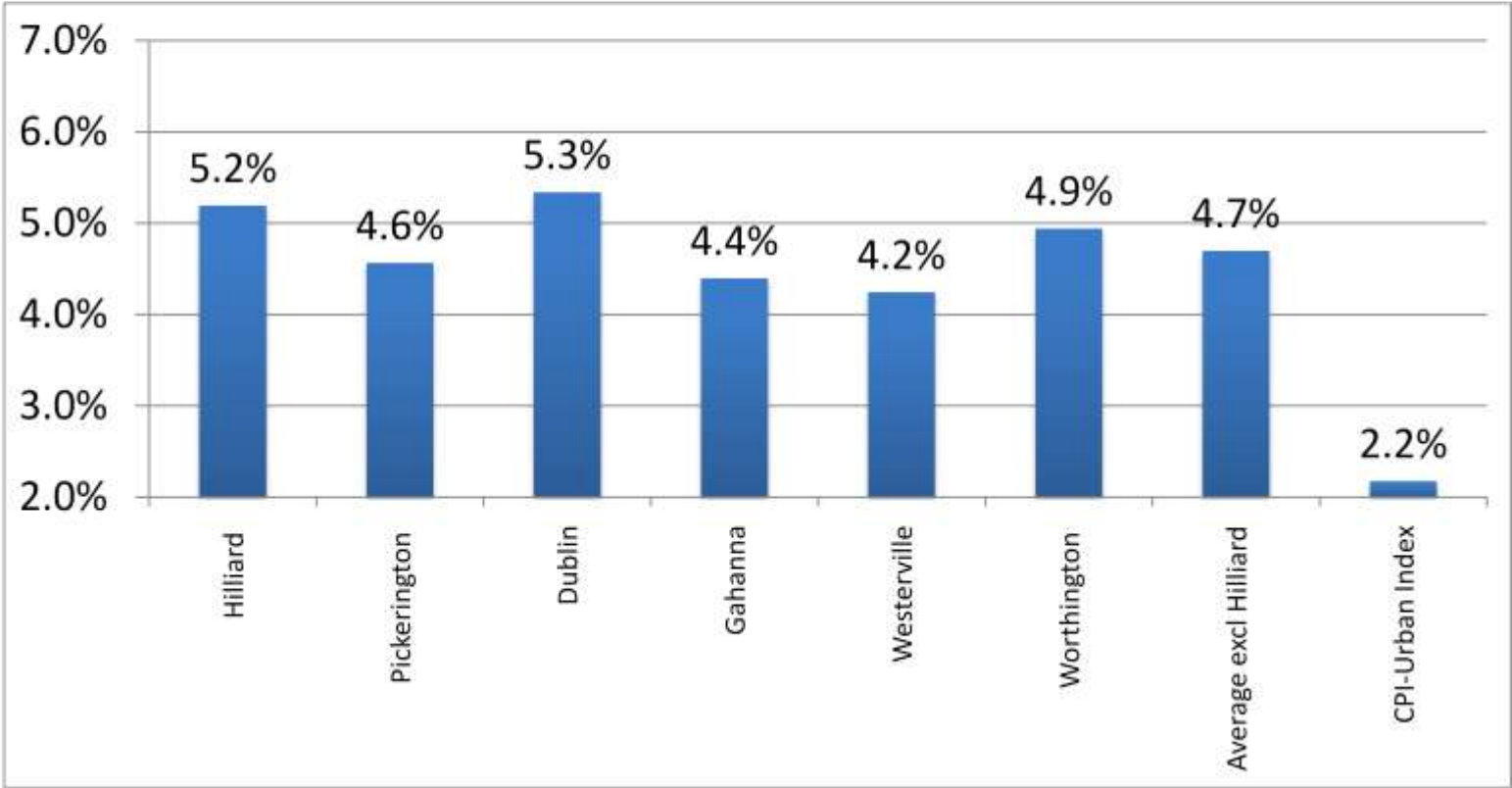


Exhibit – Illustrative Objectives and Measure

Strategic Objectives	Strategic Performance Measures	Goals and Milestones
As contained in High School 2020 As developed for K-8 2020	Education: Outcome, quality, effectiveness Graduation rates State rating ACT scores Student/Teacher ratios	Specific Measurable Achievable Relevant Time-Framed
Five-year forecast targets Financing plans Capital/building plans Contract/labor plans	Financial: Aggregate cost, revenue, balance sheet metrics Cost/ADM Debt and Credit ratios Tax base Local wealth index Sources of revenue	
Capital plan District building plan	Operational: Utilization and functional costs Building utilization ratios Bus Fleet metrics Utility consumption	
Multi-media communication plan	Communications: Community Engagement Superintendent messages Board availability Survey results Email/website utilization	