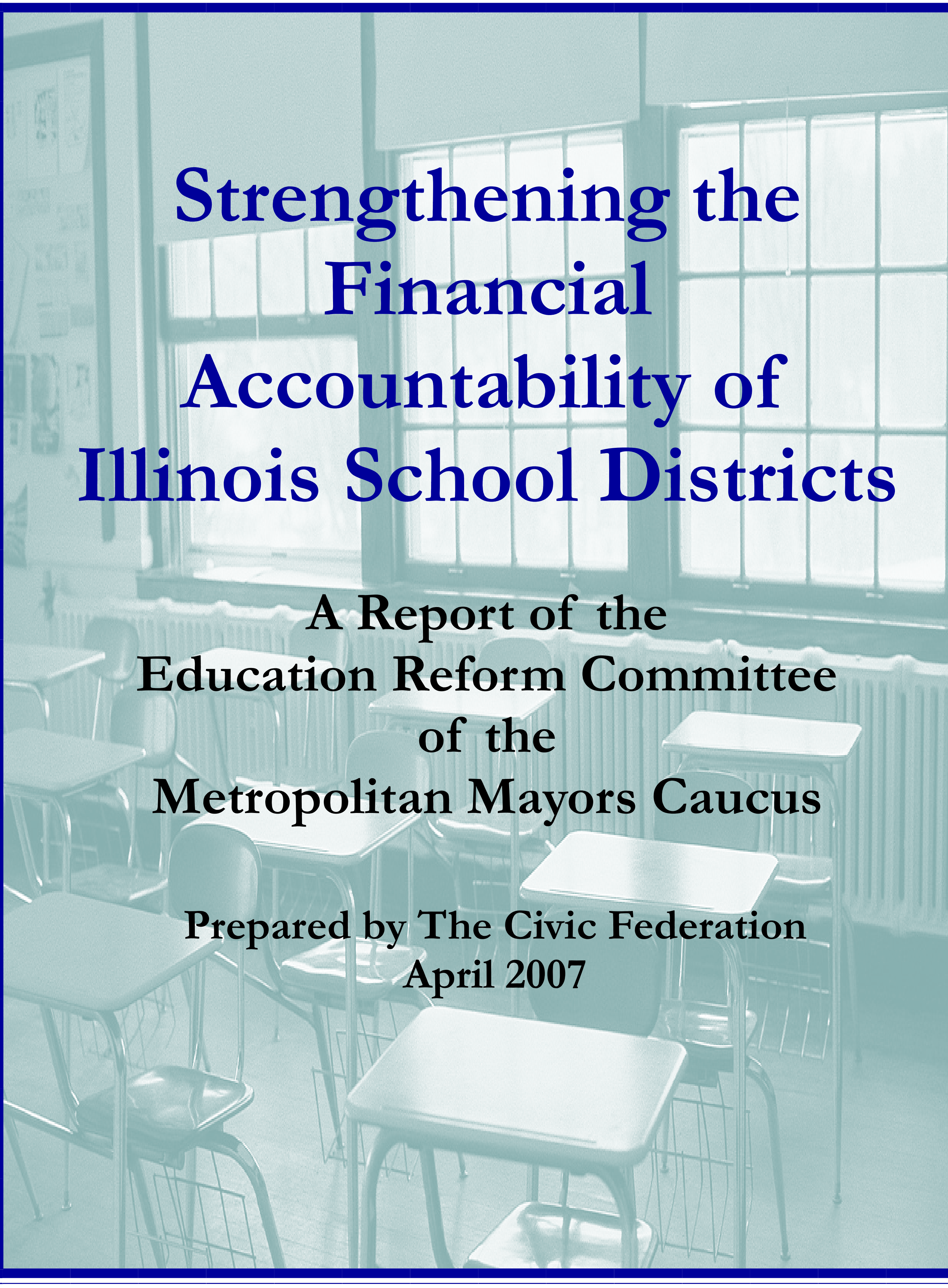

Strengthening the Financial Accountability of Illinois School Districts

A Report of the Education Reform Committee of the Metropolitan Mayors Caucus

Prepared by The Civic Federation
April 2007

ABOUT THE METROPOLITAN MAYORS CAUCUS

The Metropolitan Mayors Caucus provides a forum through which the 272 chief elected officials of the Chicago region cooperatively develop consensus on common public policy issues and multi-jurisdictional challenges. With a foundation of collaboration and consensus-based decision-making, it serves a number of functions for its partner organizations and local governments:

- The Mayors Caucus is a voice for regional approaches to issues and challenges, such as: economic development, school funding and tax reform, workforce readiness, energy reliability and security, air quality, funding for transportation and other infrastructure, housing, and emergency preparedness.

- The Caucus cooperates with leaders and agencies from the private, non-profit, and public sectors that seek to work toward the common goal of improving the well being of all who live in the region.

- The Caucus provides a forum for the discussion and resolution of issues that impact the overall quality of life in the region.

- The Mayors Caucus develops consensus positions on a broad range of key issues facing the Chicago region and is a strong advocate for their adoption at the federal, state, and local levels of government.

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ABOUT THE CIVIC FEDERATION

The Civic Federation is a nonpartisan government research organization founded in 1894. The Federation's membership includes business and professional leaders from a wide range of Chicago area companies and institutions.

The mission of the Civic Federation is to maximize the quality and cost effectiveness of government services in the Chicago region by:

- Promoting opportunities to reform local tax structures;
- Guarding against wasteful expenditure of public funds; and
- Serving as a technical resource to public officials and opinion leaders through non-partisan tax and fiscal research.

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OVERVIEW

The purpose of this report is to present specific policy recommendations to the Accountable Schools Task Force of the Metropolitan Mayors Caucus on ways to improve financial management accountability of Illinois school districts. To achieve this goal, the report:

1) Reviews current Illinois financial management and accountability oversight structures and procedures.

2) Identifies and discusses best practices and recommended practices in financial management and accountability from national organizations and governments across the nation. In addition, the Civic Federation offers several recommendations based upon its analysis of local government budgeting and financial practices.

3) Compares Illinois financial management and accountability standards with those identified through the best practices review.

4) Makes policy recommendations regarding steps Illinois should take to ensure greater financial accountability from its school districts by adopting features of the best practices and recommended practices that are most applicable to the financial management of school districts.

Methodology

The report focuses on the financial management practices of school districts, not on individual schools. The policy recommendations are based upon three sources: best practices, recommended practices, and Civic Federation recommendations. The sources used all have direct application to the particular financial management structure and processes of school districts.

Best practices are techniques, methods, or processes for achieving a desired outcome that represent the consensus view of national professional organizations such as the National Advisory Council on State and Local Budgeting (NACSLB), the Association of School Business Officials International (ASBOI), and the Government Finance Officers Association (GFOA).

Recommended practices reflect the views of both expert practitioners and other successful state efforts. The practices cited in this report are from the Budgeting and Fiscal Policy and the Accounting, Auditing and Financial Reporting Committees of the GFOA; the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA); and the State of New York's School District Accountability Initiative.

The **Civic Federation** provides several structural and process recommendations drawn from its expertise in analyzing local government finances.

Structure of the Report

This report is divided into six sections. Each section of the report includes:

- A description of the financial issue or practice, including a discussion of its importance to improving financial management accountability
- A discussion of the best practices and recommended practices in that topic area
- A description of current State of Illinois requirements
- A comparison of best and recommended practices versus State of Illinois requirements to identify gaps
- Specific Civic Federation financial management accountability process and policy recommendations based upon a review of the gaps between best and recommended practices and current State of Illinois requirements. It is proposed that the recommendations be implemented by statute and compliance monitored by the Illinois State Board of Education (ISBE).

The six sections of the report are described briefly below.

Internal Controls. Internal controls are the written procedures that are followed in order to safeguard an organization's assets, ensure the validity of records and reports, promote adherence to policies and procedures, and improve the effectiveness and efficiency of operations. This section will focus on internal and external audit requirement and internal control policies.

Planning. A high performing government must engage in comprehensive planning processes. Planning enables governments to better manage their resources, prioritize spending and identify problems before they become crises so reasonable corrective actions can be taken. There are four major components of a planning process as described below. Each component is discussed in individual sections of the report.

a) **Formal Financial Policies.** Financial policies establish written operating parameters or guidelines for a variety of key management issues to elected officials, government personnel and the public.

b) **Long Term Financial Planning.** A typical long term financial plan consists of a three to five year forecast of revenues, expenditures and debt capacity; an assessment of historic economic and financial trends; and an evaluation of problems or opportunities and actions to address them, such as gap-closing or surplus management actions.

c) **Capital Improvement Plan (CIP).** A CIP is a multi-year plan that forecasts future facility, infrastructure and equipment needs and appropriations earmarked to meet those needs. It also identifies financing sources and reports the impact of capital spending on the operating budget.

d) **Strategic Planning.** A strategic plan is a comprehensive management tool that enables organizations to evaluate their environment, prepare for and respond to changes in that environment, demonstrate commitment to their mission and develop specific strategies to achieve the mission.

Budgeting. A budget is an annual financial plan that identifies a government's policy priorities and how it will pay for those priorities. This section will review school district budget processes, formats, methods of disclosure and evaluation methods for support services and functions.

Financial Management Training. This section explores financial management training requirements for elected School Board members.

Financial Management Accountability Oversight. This section examines ways to ensure compliance by school districts to any financial management reforms ultimately approved.

Funding. The final section discusses the funding aspect of implementing any new financial management requirements on school districts.

Appendices. There are two appendices to this report. The first describes current reporting requirements mandated by the Illinois State Board of Education. The second appendix provides some examples of some of the best practice features discussed. They are drawn from information provided on selected Illinois school district Web sites. The illustrations are provided to show that many Illinois school districts already have implemented some of the recommendations presented in this report, either in part or completely. These illustrations include:

- Fiscal Goals from Hinsdale Township High School District 86
- Narrative Summary of Budget Highlights and Frequently Asked Questions from Evanston/Skokie School District 65 (2005-6)
- Narrative Summary of Tentative Budget Highlights from Wheeling Community Consolidated School District 21 (2006-7)
- Narrative Summary of the Highlights of the 2006-7 Operating Budget for Hinsdale Township High School District 86
- Financial Guidelines from Oak Park Elementary School District 97
- Evanston/Skokie School District 65 Long-Range Financial Plan 2005-6 through 2009-10 (Excerpts)
- Woodland School District 50 Projected Revenues and Expenditures: Anticipated FY2006 to Projected FY2007
- Executive Summary of the 2005-2010 New Trier Township High school District Strategic Plan

Summary of Report Recommendations

The recommendations contained in this report are summarized by financial management area below. A number of high performing Illinois school districts already comply with many of these recommendations. For these districts, the recommendations would codify their current practices into law.

For many Illinois school districts, however, implementing these reforms would require a significant shift in how they report and present their finances and related spending plans. A portion of new revenues for elementary and secondary education should be earmarked to pay for the new accountability reforms, and special funding should be made available for financially distressed school districts to enable the accountability reforms' implementation. Small school districts and school districts already experiencing fiscal distress should be encouraged to pursue intergovernmental agreements in order to minimize the work and expense of meeting the reforms' requirements. School districts should also consider soliciting the Illinois Board of Higher Education, which gathers annual fiscal and performance data from all of Illinois's community colleges, for advice on implementing effective and efficient reporting systems.

The reforms presented in this report should be presented and adopted in a single piece of legislation, but the implementation of specific recommendations could be phased in over time so that school districts can adjust to new requirements and the Illinois State Board of Education can develop accountability and oversight mechanisms that will ensure school district compliance. This report's list of recommendations is not intended to preclude the adoption of other financial management recommendations by the Metropolitan Mayors Caucus or other stakeholders.

Recommendations for Strengthened Internal Controls

Require by State statute the following school district internal control reforms:

- Create a Strong Internal Auditor Function
- Implement more rigorous External Audit Requirements
- Require School District Audit Committees
- The Illinois State Board of Education should develop a comprehensive set of internal procedures for adoption by school districts
- School Districts should submit formal, written internal control policies to the Illinois State Board of Education

Recommendations for Improved Financial Planning: Formal Financial Policies

Require by State statute the following reforms related to the adoption of formal, written financial policies.

- Formal financial policies should be adopted in the following policy areas:

    - Debt Capacity, Issuance, and Management
    - Capital Asset Management
    - Reserve or Stabilization Funds
    - Requiring Periodic Budget to Actual Comparison Reports
    - Fees and Charges
    - The Use of One-Time Revenues
    - Risk Management
    - Purchasing
    - Vehicle Acquisition and Maintenance

- The Financial Policies should be formally approved by School District Boards of Trustees

- The Formal Financial Policies Should be Made Publicly Available in Budgets and Other Documents

Recommendations for Improved Financial Planning: Long Term Financial Planning

Require by State statute the following reforms related to the development, adoption, implementation and disclosure of a long term financial plan:

- School districts should develop a formal long term financial plan (LTFP) that is updated annually.

- The LTFP should include multi-year forecasts of revenues, expenditures and debt in the LTFP. The forecasts should extend over at least a three year period.

- The long term financial plan should be made publicly available by publishing it in the budget or as a separate document and on the government's Web site. The forecasts that are the foundation of the plan should be available to participants in the budget process before budgetary decisions are made.

- Stakeholders should be provided opportunities for providing input into long term financial planning process.

- Annual formal approval of the LTFP by School District Board of Trustees should be required.

Recommendations for Improved Financial Planning: Capital Improvement Planning

Require by State statute the following reforms related to the development, adoption, implementation and disclosure of a capital improvement plan:

- All school districts should develop a formal five-year Capital Improvement Plan that is updated annually.

- A Capital Improvement Plan must include:

    - A five year summary list of projects and expenditures per project as well as funding sources per project
    - Information about the impact of capital spending on the annual operating budget for each project.
    - Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project.
    - The time frame for fulfilling capital projects and priorities.

- The Capital Improvement Plan must be made available on the school district's Web site at least ten working days prior to a public hearing.

- Each School District should hold a public hearing on the Capital Improvement Plan with opportunities for citizens to present commentary.

- School district Capital Improvement Plans should be formally adopted by School Boards of Trustees.

Recommendations for an Improved Budget Format: "User Friendly" Executive Summary

Require by State statute that each school district will annually present to the public a budget that will include a "user friendly" **Executive Summary**. The Executive Summary will include:

- School district major goals and objectives

- A discussion of major financial factors and trends affecting the budget such as changes in revenues, enrollment, and debt

- A description of the budget process

- An overview of revenues and expenditures for all funds (including three to five years of prior trends)

- An explanation of significant financial and demographic trends

- A "walk up" that explains the reasons for a budget deficit and a "walk down" that explains how the deficit was closed

- A budget forecast for three to five years in the future

- Student enrollment trends, including a future forecast
- The number of personnel by type as well as a discussion of personnel changes
- Changes in debt burden
- Relevant performance statistics

<u>Recommendations for an Improved Budget Format: Full Budget</u>

A comprehensive budget format requires that each school district will adopt Formal Financial policies and will complete both a Long Term Financial Plan and a Capital Improvement Plan This recommendation requires by State statute that each school district will annually present to the public a budget that will include the following features in the full budget document:

- An organizational chart
- Formal Financial Policies
- Long Term Financial Plan or a summary of the Long Term Financial Plan (LTFP)
- Capital Improvement Plan or a summary of the Capital Improvement Plan (CIP)

<u>Recommendations for Improved School District Budget Evaluation</u>

Require by State statute that each school district will implement the following evaluation reforms:

- Require performance measures for support service functions and programs such as facilities management, transportation, food service, central administration, etc.)
- Require that the performance measures be made publicly available in the budget or related financial documents

Recommendations for Improved School District Budget Disclosure

Require by State statute that each school district will implement the following disclosure reforms:

- The "user friendly" Executive Summary should be made publicly available on the school district's Web site (each District's line item budget currently must be placed on the District's Web site).

Recommendations for Mandatory Financial Management Training for School Board Members

Require by State statute the following educational requirements for elected school district officials:

- The State of Illinois should require all school board members to complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities.

- The training must be completed within a year of election and could be provided by an Illinois State Board of Education approved trainer.

Recommendations for Financial Management Accountability Oversight

Require by State statute that the Illinois State Board of Education be given the following financial management oversight responsibilities:

- An Office of State School District Financial Management Accountability within the Illinois State Board of Education should be created to monitor progress made by school districts in meeting the statutory requirements of approved reforms.

- School districts failing to meet approved financial management reform standards within a reasonable, specified timetable would be placed under the direct oversight of the Office of State School District Financial Management Accountability.

- School districts placed under State supervision would be required to develop a three-year improvement plan to meet the reform standards.

- ISBE would withhold funds from school districts failing to fulfill State financial management accountability requirements and would be empowered to remove and replace non-complying financial management administrators.

Recommendations for Funding the School Financial Management Accountability Reforms

Require by State statute that the following mechanisms be established regarding funding of the school district financial management accountability reforms:

- A portion of any new revenues for elementary and secondary education should be earmarked for the purpose of providing funding for implementation of the new financial management accountability reforms. This funding requirement should be included in any school financing reform statute ultimately adopted.

- The amount to be earmarked will be based on a review of estimated new administrative costs conducted under the direction of the Illinois State Board of Education.

- The administrative funding amount and mechanism implemented should be reviewed every five years to determine its adequacy.

- Periodic adjustments to the amount and method of funding administrative costs should be made based on the five year review.

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INTERNAL CONTROLS

Internal controls are the written procedures that are followed in order to safeguard an organization's assets, ensure the validity of records and reports, promote adherence to policies and procedures, and improve the effectiveness and efficiency of operations. These procedures embrace a range of functions. They include guidelines for carrying out routine tasks such as receiving funds or approving and disbursing payments from petty cash, but they also define an organization's mechanisms for monitoring its finances and operations. Internal controls should be designed so that procedural controls and broader oversight controls work together as a comprehensive system of protections.

Governments implement comprehensive internal control policies in order to achieve the following goals[1]:

- Continually assess and minimize operational risks and the potential for financial mismanagement.
- Promote effective communication between different levels of management.
- Ensure compliance with policies and procedures.
- Identify and resolve operational problems.
- Ensure that employee turnover will not disrupt operational continuity.

The Illinois School Code and the Illinois State Board of Education (ISBE) enumerate extensive and detailed accounting and reporting requirements for Illinois school districts. These requirements (which are listed in the "State of Illinois Requirements" section below) are the state's strongest financial management accountability standards and are in substantial compliance with Government Finance Officers Association (GFOA) recommendations for best practices. The Best Practices and Recommended Practices section below describes internal control policies that pertain to areas other than accounting and financial reporting.

Best Practices and Recommended Practices in Internal Controls

The Government Finance Officers Association (GFOA) has developed descriptions of best practices in internal controls. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) and the Office of the New York State Comptroller have developed several recommended practices in this policy area. A summary of the key recommendations for best practices is as follows:

[1] These descriptions summarize the goals and descriptions provided in Stephen J. Gauthier's *Evaluating Internal Controls: a Local Government Manager's Guide* (Chicago: Government Finance Officers Association, 1996), pp. 2-3.

1. Create a Strong Internal Auditor Function

   School districts should establish an internal auditor position that is responsible for reviewing payment for district expenses. The internal auditor should also function as a "super control" that enhances the effectiveness of the school district's other internal controls. An effective internal audit function can contribute significantly to improving the quality of the overall control environment. The internal auditor should report directly either to top management of the school district or to the elected school board.

   (See Office of the New York State Comptroller, *School District Accountability Initiative: 2005 Annual Report* (December 2005), pp. 7-9; and Stephen J. Gauthier, *Evaluating Internal Controls: a Local Government Manager's Guide* (Government Finance Officers Association, Chicago: 1996).)

2. Implement Rigorous External Audit Requirements

   The external auditor should present the annual audit report directly to the school board at a publicly-held meeting. Districts should be required to use a competitive request for proposal (RFP) process for selecting external audit firms.

   (See Office of the New York State Comptroller, *School District Accountability Initiative: 2005 Annual Report* (December 2005), pp. 7-9.)

3. Require a Competitive RFP Process for Selecting External Auditors

   After a district has selected an external audit firm, it may engage that firm annually for up to five years, at which point it must repeat the RFP process. School districts should be prohibited from contracting the same outside auditor for more than five consecutive years.

   (See Office of the New York State Comptroller, *School District Accountability Initiative: 2005 Annual Report* (December 2005), pp. 7-9.)

4. Require Audit Committees

   Even the smallest school districts should be required to establish an audit committee that assists the school board with it financial oversight responsibilities. The audit committee's specific purpose is: 1) to ensure that the auditor of the financial statements is truly independent of management, 2) to provide an objective perspective on internal control matters and financial statement audits, and 3) to provide a communications link between management, the independent auditor, and the governing board. At least half of the audit committee should consist of members who are not on the board of education. All audit committee members should have relevant financial training and experience.

   (See Office of the New York State Comptroller, *School District Accountability Initiative: 2005 Annual Report* (December 2005), pp. 7-9; and Stephen J. Gauthier, *Evaluating Internal Controls: a Local Government Manager's Guide* (Government Finance Officers Association, Chicago: 1996).)

5. Require School Districts to Submit Written Internal Control Policies to ISBE

   A government's internal control policies must be written and should be reviewed periodically to ensure their efficiency and efficacy. ISBE should require each Illinois school district to: 1) develop comprehensive internal control policies; 2) submit internal control policies in writing to ISBE; and 3) review existing policies periodically to ensure that they are functioning as designed. Because internal controls can only function effectively in an environment where management stresses their importance to employees, school districts should also be required to submit a description of steps that management has taken and plans to take in order to create a favorable environment for internal controls.

   (The Civic Federation, based on its expertise in reviewing government finance.)

6. Create a Comprehensive Set of Internal Control Recommendations for School Districts

   ISBE should publish a manual that instructs school district managers in how to design and implement a comprehensive internal control system. This manual should guide school districts in the development and adoption of internal control policies in the three areas described in the "Specific Types of Internal Control Policies" section below.[2]

   (The Civic Federation, based on its expertise in reviewing government finance.)

Specific Types of Internal Control Policies

This section identifies by area specific types of internal control policies. These descriptions are adapted from Stephen J. Gauthier's *Evaluating Internal Controls: a Local Government Manager's Guide* (Government Finance Officers Association, Chicago: 1996).

7. Require Adoption of Risk Assessment Policies

   School districts should seek to identify as early as possible risks or other factors that may impair or hinder the district's ability to act effectively and efficiently, comply with laws and regulations, and report its finances properly. School districts should address:

   - The distribution of risk monitoring tasks so that all levels of management are involved,

   - Monitoring and anticipating district growth or decline,

   - Monitoring and anticipating relevant changes in the district's operating environment, personnel, information systems and technology, programs and services, and organizational structure, and

[2] ISBE has produced a manual entitled *The Illinois Program Accounting Manual for Local Education Agencies* that provides detailed information on regulations and procedures for accounting and budgeting of elementary and secondary local education agencies (LEA) in Illinois. This manual does not, however, provide guidance on how to formulate other internal control policies.

- Monitoring and anticipating the inherent risk associated with the complexity of district activities, the handling of its cash receipts, the centralization or decentralization of decision-making, and prior problems.

8. Require Adoption of Control-Related Policies and Procedures

   Once identified, risks must be controlled. School districts should develop and implement control policies that address the following:

   - Segregation of incompatible duties so that no single employee has the authority to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction,

   - Periodic reconciliation and verification of accounts, and

   - Performance of analytical reviews to ensure that revenues and expenditures align with reasonable expectations.

9. Require Adoption of Monitoring Policies

   Internal controls should regularly be examined to ensure that they are functioning as designed and potential problems identified by internal controls should be handled according to policies that ensure internal controls are achieving desired results. Specifically:

   - The internal auditor should be assigned responsibility for periodically testing the effectiveness of internal controls, and

   - The resolution of all potential problems or conflicts uncovered by internal controls should be explained in writing and supported by appropriate documentation.

   -

State of Illinois Requirements

The State's prescribed internal controls for school districts consist primarily of accounting, budgeting, and reporting rules and requirements. The State publishes these rules and requirements, as enumerated in the Illinois School Code, in the Illinois State Board of Education (ISBE) chapter of the Illinois Administrative Code, which is available on ISBE's website. The rules and requirements are as follows:

1. Each school district must develop and maintain a chart of accounts based on ISBE specifications and ISBE account numbers. (110.10)

2. School district accounts must be organized into "funds," independent fiscal and accounting entities requiring their own sets of self-balancing accounts. These must be used in accordance with ISBE restrictions and limitations that earmark each fund for a specific activity or for attaining certain objectives. All transactions must be identified by fund. (110.20)

3. With certain exceptions enumerated in the School Code, interest from funds may be transferred to other funds absent specific restrictions by Board resolution. Those funds that may not be transferred include funds earmarked for Illinois Municipal Retirement, Tort Immunity, Fire Prevention and Safety, Environmental and Energy, and Capital Improvements. (110.25)

4. Entries made in a school district's revenue and expenditure ledgers are carefully regulated. Revenue transactions must be coded according to their source (local, state, or federal). Local Educational Agencies (LEAs) must categorize expenditures according to the "dimensions" used in their accounting system (i.e., fiscal year, fund, operational unit, etc.), and the minimum requirements for each expenditure entry is a one-digit code for fund, a four-digit code for function, and a one-digit code for object. Category classifications and codes are prescribed for nearly all types of revenues and expenditures. (110.40-110.80, Appendices A-D)

5. All LEAs must annually complete budget and financial report forms using a format provided by ISBE. (110.90)

6. Each district's board of trustees must formally adopt a budget by September 1. Budgets must be adopted at a public meeting and the board must take a roll call vote. The adopted budget must be incorporated into the meeting minutes. (110.100)

7. School districts must submit Annual Financial Reports (AFRs) to the Superintendent of the Educational Service Region on or before the October 15 that immediately follows the fiscal year's end, and the Regional Office must forward district reports to ISBE by November 15 of that same year. (Chicago Public Schools submits its AFR directly to ISBE by February 15.) District AFRs must be completed by an independent Certified Public Accountant. The Service Region Superintendent is responsible for carrying out a district audit if the District fails to submit the completed AFR in time (or by a previously-granted extension deadline). The Service Region Superintendent is also authorized to withhold State funds from districts that do not file their reports on time. (110.110)

8. Regional Offices of Education must maintain records that can be reviewed by an independent auditor selected by ISBE. Records for a given year must be in an auditable form by August 15 of the succeeding fiscal year, and Regional Offices' financial reports for that year must be completed by August 31. The audit report is presented to the Regional Office of Education Oversight Board at the first Board meeting following the audit's completion. (110.115)

The Illinois School Code also mandates internal controls that specifically pertain to School Districts' Revolving (Imprest) Funds and Petty Cash Funds:

1. A Revolving or Imprest Fund may be established by resolution of the school board for the purpose of permitting the districts to issue a check when it wishes to do so but, because of timing or emergencies, cannot pay through the regular disbursement procedures. Accounting rules for this type of fund, which must be approved by resolution of the school board, stipulate that only the entries that open and close the fund are recorded with the Revolving (Imprest) Fund account number. The board's resolution authorizing the fund must also designate the size of the fund, and the amount of money in

the fund and the receipts for payments made must total this amount at all times. Payments are made out of the fund upon presentation of vouchers or other pre-approved documentation, and all transactions out of the fund must include appropriate expenditure codes. The fund's custodian must be bonded. (110.125)

2. A Petty Cash Fund may be established by resolution of the school board for the purpose of making change, immediate payments, or other payments for which it would be uneconomical to follow regular disbursement procedures. The board must also designate the amount of the fund. A custodian of the fund is appointed. He or she must be someone other than the person who approves expenditures (by signature) and must be bonded. The amount of cash that remains in the fund and the receipts for funds paid out must equal the fund amount authorized by the board at all times. (110.135)

Comparison: Best or Recommended Practices v. State of Illinois Requirements

FORMAL INTERNAL CONTROLS POLICIES CHECKLIST	
Best or Recommended Practice	**State of Illinois Requirement**
1. Create a Strong Internal Auditor Function	No
2. Implement Rigorous External Audit Requirements	No
3. Require a Competitive RFP Process for Selecting External Auditors	No
4. Require Audit Committees	No
5. Require School Districts to Submit Written Internal Control Policies	No
6. Create a Comprehensive Set of Internal Control Recommendations	No
7. Require Adoption of Risk Assessment Policies	No
8. Require Adoption of Control-Related Policies and Procedures	No
9. Require Adoption of Monitoring Policies	No
10. Adopt Formal Accounting Prodcedures	Yes
11. Adopt Formal Reporting Procedures	Yes

Recommendations

Based on a review of best and recommended practices in the development of formal internal control policies, it is recommended that the following school district internal control measures be adopted by statute by the State of Illinois.

1. Require school districts to create an internal auditor position that reports directly to top management or the elected school board.

2. Require that external auditors present their findings directly to the school board at publicly-held meetings.

3. Require school districts to issue Requests for Proposals when selecting audit firms and change audit firms after a maximum of five years.

4. Require the establishment of audit committees to advise school boards about financial matters.

5. Require school districts to submit written internal control policies to ISBE that address the following policy areas:
   - Risk Assessment
   - Control-Related Procedures
   - Monitoring

6. Publish a manual that guides school districts in the development and implementation of a comprehensive set of internal controls.

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PLANNING

A high performing government must engage in comprehensive planning processes. Planning enables governments to better manage their resources, prioritize spending and identify problems before they become crises so reasonable corrective actions can be taken. There are four major components of a planning process as in the individual sections that follow:

1. Formal Financial Policies
2. Long Term Financial Plan
3. Capital Improvement Plan
4. Strategic Plan

Formal Financial Policies

Formal financial policies establish operating parameters or guidelines for a variety of key management issues. Essentially, they provide government personnel and the public with a written list of what is permitted and what is not. They also provide guidance to the governing body in its decision-making process.

Governments typically develop financial policies in the following broad functional areas:

- Operating budget
- Revenues and Expenditures
- Reserves
- Capital improvements
- Debt management
- Procurement
- Risk management
- Human resources
- Accounting, auditing and financial reporting[3]

[3] Shayne Kavanagh and Wright Anderson Williams *Financial Policies: Design and Implementation* (Chicago: Government Finance Officers association, 2004), p. 2

Best Practices and Recommended Practices for Formal Financial Policies

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) have developed best practices for formal financial policies. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) also has developed several recommended practices in this area. A summary of the key recommendations of those practices that have the most direct application to school districts follows.

1. <u>Adopt Formal Financial Policies</u>

   All governments should require their professional staffs to develop formal financial policies. Financial policies should be reviewed on a regular basis to ensure continued relevance. At a minimum, governments should adopt financial planning, revenue and expenditure policies.

   (See Government Finance Officers Association Recommended Practice on the Adoption of Financial Policies – 2001.)

2. <u>Require Formal Approval of Financial Policies by School District Board of Trustees</u>

   Financial policies should be formally approved by the governing body of the school district. It is imperative that elected officials be fully aware of the policies guiding decision-making in the district.

   (See Government Finance Officers Association Recommended Practice on the Adoption of Financial Policies – 2001.)

3. <u>Make Financial Policies Publicly Available</u>

   Adopted formal financial policies should be summarized and published in the budget or other public documents and made widely available to policymaker and citizens.

   (See Government Finance Officers Association Recommended Practice on the Adoption of Financial Policies – 2001.)

Specific Types of Formal Financial Policies

The following list summarizes the specific types of formal policies that school districts should consider adopting.

4. Adopt a Policy on Debt Capacity, Issuance, and Management

A jurisdiction should adopt a policy that specifies appropriate uses for debt and identifies the maximum amount of debt and debt service that should be outstanding at any time. To assist in this process, governments should evaluate debt capacity prior to issuing debt.

(See NACSLB Recommended Practice 4.3: Develop Policy on Debt Issuance and Management and 4.3a: Develop Policy on Debt Level and Capacity, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Cost Control Systems.)[4]

5. Adopt a Policy on Capital Asset Management

Jurisdictions should adopt a policy to regularly inventory and assess the condition of all major capital assets. This information should be used to plan for the ongoing financial commitments required to maximize the public's benefit.

(See NACSLB Recommended Practice 2.2: Assess Capital Assets, and Identify Issues, Opportunities, and Challenges, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Cost Control Systems.)[5]

6. Adopt a Policy on Reserve or Stabilization Funds

Jurisdictions should adopt a policy to ensure that a prudent level of financial resources is available to provide for contingencies. School districts should maintain a reserve fund of at least 5% of operating revenues.

(See NACSLB Practice 4.1: Develop Policy on Stabilization Funds, Government Finance Officers Association Recommended Practice on the Appropriate Level of Unreserved Fund Balance in the General Fund – 2002.)

7. Adopt a Policy that Requires Periodic Budget to Actual Comparison Reports

Jurisdictions should adopt a policy that requires comparisons of actual expenditures to budgeted expenditures periodically (e.g., quarterly) and then to decide on actions to bring the budget into balance, if necessary.

(See NACSLB Recommended Practice 7.2: Develop Mechanisms for Budgetary Compliance.)

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[4] See Point 15 of the Cost Control Systems Best Financial Management Practices Guidelines for School Districts, p. 66. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

[5] See Points 13 (Capital Asset Management) and 21 (Inventory Management) of the Cost Control Systems Best Financial Management Practices Guidelines for School Districts, pp. 65 and 67. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

8. Adopt a Policy on Fees and Charges

   School districts should adopt policies that delineate how fees and charges are established and how much of the cost of the service provided they cover.

   (See NACSLB Recommended Practice 4.2: Develop Policy on Fees and Charges.)

9. Adopt a Policy on the Use of One-Time Revenues

   All governments should adopt a policy that discourages the use of on-time revenues for recurring expenditures and specifies how such revenues will be used.

   (See NACSLB Recommended Practice 4.4: Develop Policy on Use of One-Time Revenues.)

10. Adopt a Risk Management Policy

    Jurisdictions should establish written risk management policies and procedures. These policies and procedures should be updated periodically.

    (See the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Cost Control Systems.)[6]

11. Adopt Purchasing Policies

    Governments should adopt written purchasing policies and procedures that allow them to take maximum advantage of competitive bidding, volume discounts, and special pricing agreements.

    (See the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Cost Control Systems.)[7]

12. Adopt a Policy on Vehicle Acquisition and Maintenance

    School districts should adopt policies regarding the acquisition, replacement and maintenance of school buses and other district vehicles. The replacement policy should include criteria such as age of the vehicle, vehicle mileage, and maintenance costs vs. vehicle value. The policy should be reviewed periodically to ensure continued relevance.

    (See the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Transportation.)[8]

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[6] See Point 17 (Risk Management) of the Cost Control Systems Best Financial Management Practices Guidelines for School Districts, p. 66. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.
[7] See Point 20 (Purchasing) of the Cost Control Systems Best Financial Management Practices Guidelines for School Districts, p. 67. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.
[8] See Point 8(a) of the Transportation Best Financial Management Practices Guidelines for School Districts, p. 50. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

State of Illinois Requirements

The Illinois Public Funds Investment Act requires all local governments, including school districts, to develop and adopt a written investment policy. The Act specifies items that must be addressed by an investment policy.[9] Many school districts undoubtedly have developed either informal or formal policies in various areas. However, the State does not require school districts to develop and make publicly available any other formal financial policies.

Comparison: Best or Recommended Practices v. State of Illinois Requirements

FORMAL FINANCIAL POLICIES CHECKLIST	
Best or Recommended Practice	**State of Illinois Requirement**
1. Adopt Formal Financial Policies	No
2. Require Formal Approval of Financial Policies by School District Board of Trustees	No
3. Make Financial Policies Publicly Available	No
4. Adopt Financial Policies on Debt Capacity, Issuance, and Management	No
5. Adopt a Policy on Capital Asset Management	No
6. Adopt a Policy on Reserve or Stabilization Funds	No
7. Adopt a Policy that Requires Periodic Budget to Actual Comparison Reports	No
8. Adopt a Policy on Fees and Charges	No
9. Adopt a Policy on the Use of One-Time Revenues	No
10. Adopt a Risk Management Policy	No
11. Adopt Purchasing Policies	No
12. Adopt a Policy on Vehicle Acquisition and Maintenance	No

Recommendations

Based on a review of best and recommended practices in the development of formal financial policies it is recommended that the following school district financial accountability measures be adopted by the State of Illinois by statute.

[9] 30 ILCS 235/2.5.

1. Require that school districts adopt formal financial policies in the following policy areas:
    - Debt Capacity, Issuance, and Management
    - Capital Asset Management
    - Reserve or Stabilization Funds
    - Requiring Periodic Budget to Actual Comparison Reports
    - Fees and Charges
    - The Use of One-Time Revenues
    - Risk Management
    - Purchasing
    - Vehicle Acquisition and Maintenance
2. Require Formal Approval of the Financial Policies by School District Board of Trustees
3. Make the Formal Financial Policies Publicly Available in Budgets and Other Documents

Long Term Financial Planning

Long term or long range financial planning is a strategic process that provides governments with the insights and information they need to establish multi-year budgeting and financial policies and pursue actions that maintain good fiscal health. A long term financial plan (LTFP) is a formal document that summarizes the information and insights developed during the long term financial planning process.

A typical LTFP consists of a three to five year forecast of revenues, expenditures and debt capacity; an assessment of historic economic and financial trends; and an evaluation of problems or opportunities and actions to address them, such as gap-closing or surplus management actions. The benefits of long term financial planning include helping to determine if:

- Revenues are adequate to maintain services at current levels,
- Financial resources are sufficient to address future operating and capital expenditures,
- It is possible to expand existing programs or initiate new ones, or
- It is prudent to issue new debt to fund new capital projects.

By effectively linking policy and program priorities to the financial resources available currently and in the near future, the long term financial planning process helps governments prepare for future contingencies before they become crises.

Best Practices and Recommended Practices in Long Term Financial Planning

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) have developed best practices in capital improvement planning. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) also has developed several recommended practices in this policy area. A summary of the key recommendations from these institutions follows.

1. <u>Conduct Long Range Financial Planning</u>

   All governments should develop and implement a formal financial planning process that assesses the long term financial implications of current and proposed policies and assumptions and that develops appropriate strategies to achieve its goals. The formal long term financial plan should be updated annually and approved by the governing body.

   (See NACSLB Recommended Practice 9.1: Conduct Long Range Financial Planning, Civic Federation Budget Analyses of Local Government Budget – various years.)

2. <u>The LTFP must include Multi-Year Revenue, Expenditure and Enrollment Forecasts</u>

   All governments should prepare multi-year projections of revenues and other resources, expenditures and debt. School districts should also develop projections of student enrollment. These projections are particularly important as State aid is based in part on enrollment and spending is driven in large part by student population trends.

   Forecasts should extend over a period of at least three years into the future. A government may produce a single projection or projections under various scenarios; alternatively, a forecast may be stated in terms of a range of values. The forecasts should include identification of major assumptions and documentation of methodologies used.

   Regarding enrollment forecasts, school districts should base projections on proven statistical methods that can more accurately quantify the impact of changing demographic trends. The forecasts also should consider other factors that may influence enrollment such as employment or economic changes, planned new developments or comprehensive plans. A process should be developed to minimize any adverse impacts of forecasting errors. Individual school enrollment projections should consider existing populations, mobility of population and housing starts within the school service area.

   (See NACSLB Recommended Practice. 9.2: Prepare Revenue Projections, NACSLB Recommended Practice 9.4: Prepare Expenditure Projections and NACSLB Recommended Practice 4.3a: Develop Policy on Debt Level and Capacity, the State of Florida Office of

Program Policy Analysis and Government Accountability, Best Financial Management Practices, Management Structures.)[10]

3. Make Long term Financial Plan Publicly Available

   The LTFP should be available to decision makers for their review in making choices and decisions related to the budget process. The plan may be summarized in the government's budget document or in a separate report. It also should be put on the government's Web site. The forecasts that are the foundation of the Plan should be available to participants in the budget process before budgetary decisions are made.

   (See NACSLB Recommended Practice 9.1: Conduct Long Range Financial Planning.)

4. Provide Opportunities for Stakeholder Input into Long Term Financial Planning Process

   Stakeholders, including elected officials and citizens, should have opportunities to provide input into the development of the LTFP. These opportunities could include participation in citizen advisory committees and/or hearings prior to adoption of the Long Term Financial Plan

   (See NACSLB Recommended Practice 9.1: Conduct Long Range Financial Planning.)

5. Require Formal Approval of LTFP by School District Board of Trustees

   The LTFP should be formally approved by the governing body of the government. It is imperative that elected officials be fully aware of long term financial trends that may impact future budgets and plans.

   (See NACSLB Recommended Practice 9.1: Conduct Long Range Financial Planning.)

State of Illinois Requirements

Many Illinois school districts employ many of the techniques of a long term financial planning process internally, including the projection of multi-year revenue trends. However, few have developed a formal long term financial planning process that is made publicly available.

The State of Illinois does not require school districts to develop and make publicly available long term financial plans with the exception of schools that are in financial distress. Schools certified as being in financial difficulty may be required by the State Board of Education to develop, adopt and submit a financial plan to the School District Financial Oversight Panel established by the State Board of Education and empowered to review the district's finances for approval. The initial plan is required to be for the remaining part of the current fiscal year and the next two succeeding years. Subsequent plans are to be prepared for a three year period.[11]

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[10] See Point 10 a. – h. of the Management Structures Best Financial Management Practices Guidelines for School Districts, p. 5. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

[11] (105 ILCS 5/1B-12) (from Ch. 122, par. 1B-12). Sec. 1B-12. Financial Plans.

Comparison: Best or Recommended Practices vs. State of Illinois Requirements

LONG TERM FINANCIAL PLAN CHECKLIST	
Best or Recommended Practice	**State of Illinois Requirement**
1. Conduct Long Range Financial Planning	No
2. The Long Term Financial Plan must include Multi-Year Revenue, Expenditure, Debt and Enrollment Forecasts	No
3. Make Long Term Financial Plan Publicly Available	No
4. Provide Opportunities for Stakeholder Input into Long Term Financial Planning Process	No
5. Require Formal Approval of LTFP by School District Board of Trustees	No

Recommendations

Based on a review of best and recommended practices in long term financial planning, it is recommended that the following school district financial accountability measures be adopted by the State of Illinois by statute.

1. Develop a formal long term financial plan that is updated annually.

2. Include multi-year forecasts of revenues, expenditures and debt in the LTFP. The forecasts should extend over at least a three year period.

3. Make the long term financial plan publicly available by publishing it in the budget or as a separate document and on the government's Web site. The forecasts that are the foundation of the plan should be available to participants in the budget process before budgetary decisions are made.

4. Provide opportunities for stakeholder input into long term financial planning process.

5. Require annual formal approval of the LTFP by School District Board of Trustees.

Capital Improvement Plan

A capital improvement plan (CIP) is a multi-year plan that forecasts future facility, infrastructure and equipment needs and appropriations earmarked to meet those needs. It also identifies financing sources and reports the impact of capital spending on the operating budget. A CIP may be forecast for a period of time ranging from three to ten years. The first year of the CIP becomes the jurisdiction's capital budget for that fiscal year. A CIP is updated annually.

The capital needs of a jurisdiction typically exceed the amounts of funds available. The CIP is an important tool in assisting governments in the process of prioritizing projects and identifying funding sources for these projects.

Developing a CIP is an important financial accountability measure because capital projects are costly and must be paid for over a number of years that the funds are borrowed.

It must be recognized that a CIP is a planning tool, not a rigid set of requirements. As such, it is subject to change over time as circumstances change.

Best Practices and Recommended Practices in Capital Improvement Planning

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) have developed best practices in capital improvement planning. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) and the Civic Federation also have developed several recommended practices in this policy area. A summary of the key recommendations of these practices follows.

1. <u>Develop a Formal Five-Year Capital Improvement Plan</u>

   All governments should develop a five-year capital improvement plan that identifies priorities, provides a timeline for completing projects and identifies funding sources for projects. The CIP should be updated annually and be approved formally by the governing body.

   (See NACSLB Recommended Practice 9.6: Develop a Capital Improvement Plan, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Facilities Construction.)[12]

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[12] The State of Florida requires school districts to prepare a comprehensive Five-Year Educational Plan Surveys. This is Point 1. d. of the Facilities Construction: Construction Planning Best Financial Management Practices Guidelines for School Districts. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

2. Required Information in a Capital Improvement Plan

A capital improvement plan should include the following information:

- A five year summary list of projects and expenditures per project as well as funding sources per project.
- Information about the impact of capital spending on the annual operating budget for each project.
- Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project.
- The time frame for fulfilling capital projects and priorities.

(See NACSLB Recommended Practice 9.6: Develop a Capital Improvement Plan, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Facilities Construction.)[13]

3. Make Capital Improvement Plan Publicly Available

The Capital Improvement Plan should be made publicly available for review by elected officials and citizens. It should be published in the budget document or in a separate capital improvement plan. The CIP should be made available on the government's Web site. The public should be permitted at least ten working days to review the CIP prior to a public hearing.

(See NACSLB Recommended Practice 9.6: Develop a Capital Improvement Plan, Civic Federation Budget Analyses of Local Government Budget – various years.)

4. Provide Opportunities for Stakeholder Input into Capital Improvement Planning Process

It is important to consider the views of stakeholders, including taxpayers, in developing a CIP. To achieve this goal, stakeholders, including citizens, should have opportunities to provide input into the development of the CIP. These opportunities could include participation in citizen advisory committees and/or hearings different phases of CIP development. The governing body should hold a public hearing prior to adoption of the Capital Improvement Plan. The hearing would include opportunities for citizen commentary.

(See NACSLB Recommended Practice 9.6: Develop a Capital Improvement Plan, Civic Federation Budget Analyses of Local Government Budgets – various years.)

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13 The State of Florida requires school districts to prepare five year facilities plans that establish budgetary plans and priorities. This is Point 3. a to c. of the Facilities Construction: Construction Planning best financial management practices guidelines for school districts. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

5. Require Formal Approval of CIP by School District Board of Trustees

   The CIP should be formally approved by the governing body of the government. It is imperative that elected officials be fully aware and supportive of long term plans that commit significant public resources.

   (See Civic Federation Budget Analyses of Local Government Budgets – various years.)

State of Illinois Requirements

Some school districts, such as the Chicago Public Schools, do develop multi-year capital improvement plans. The CPS, which initiated a formal CIP process in 1996, provides information about its program on its Web site at www.cps.k12.il.us/operations/cip.html. However, the State of Illinois does not require school districts to develop and make publicly available a capital improvement plan.[14]

Comparison: Best or Recommended Practices vs. State of Illinois Requirements

CAPITAL IMPROVEMENT PLAN CHECKLIST	
Best or Recommended Practice	**State of Illinois Requirement**
1. Develop a Formal 5-Year Capital Improvement Plan	No
2. Required Information in a Capital Improvement Plan 3. A 5-year summary list of projects and expenditures per project 4. Impact of capital spending on the annual operating budget 5. Narrative descriptions of individual projects 6. Time frame	No
7. Capital Improvement Plan Made Publicly Available	No
8. Public Hearing Held on the Capital Improvement Plan	No
9. School District Board of Trustees Formally Approve CIP	No

[14] The Illinois General Assembly authorized a construction program for elementary and secondary education in 1997 to assist school districts with their capital costs. The planning for these efforts is coordinated jointly by the Illinois State Board of Education and the Capital Development Board. Every two years, the two State agencies, in cooperation with Regional Offices of Education, are required to evaluate school construction needs in the State. See *FY2006 State of Illinois Capital Budget*, p. 31.

Recommendations

Based on a review of best and recommended practices in capital improvement programming, it is recommended that the following school district financial accountability measures be adopted by the State of Illinois by statute.

1. Develop a Formal Five Year Capital Improvement Plan that is updated annually.

2. Require that Capital Improvement Plans include:

    - A five year summary list of projects and expenditures per project as well as funding sources per project.

    - Information about the impact of capital spending on the annual operating budget for each project.

    - Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project.

    - The time frame for fulfilling capital projects and priorities.

3. Require that Capital Improvement Plans be made available on the school district's Web site at least ten working days prior to a public hearing.

4. Each School district should hold a public hearing on the Capital Improvement Plan with opportunities for citizens to present commentary.

5. School district Capital Improvement Plans should be formally adopted by School Boards of Trustees.

Strategic Planning

A strategic plan is a comprehensive management tool that enables organizations to:

- Evaluate their environment,

- Prepare for and respond to changes in that environment,

- Demonstrate commitment to their mission, and

- Develop specific strategies to achieve the mission.

Developing a strategic plan is essential for an organization to fulfill its missions, meet its mandates, and satisfy the needs and requirements of its stakeholders. Simply put, an organization's goals are more likely to be met if there are clearly defined strategies and plans to support the achievement of those goals.

Capital improvement plans, long term financial plan and formal financial policies are all essential financial planning components of a comprehensive strategic plan. They provide the necessary insights and information an organization requires to clearly understand the environment in which it operates and to rationally prepare and implement plans to fulfill its mission. The elements of a strategic planning process include:[15]

- *Develop a mission statement.* The first step in the strategic planning process is to develop a mission statement, which is a broad, clear statement of purpose for the organization. All of the organization's goals, strategies and programs should cascade from the mission statement.

- *Assess environmental factors.* An assessment of external and internal environmental factors that impact the ability of an organization to operate. These include economic, demographic, legal, social, cultural, intergovernmental, stakeholder and technological issues.

- *Identify critical issues.* After environmental factors have been identified, the next step is to identify the most critical issues that emerge. This process should incorporate stakeholder needs and concerns as well as broad environmental factors.

- *Develop broad goals.* After critical issues have been identified, the next step in the strategic planning process is to develop a limited number of written, broad goals to address those issues. Broad goals define an organization's priorities and serve as the foundation for resource allocation decisions

- *Develop strategies to achieve goals*. Strategies or objectives should be developed to map out how the broad goals will be implemented.

- *Create an action plan*. After goals and objectives have been delineated, it is time to describe in detail what actions must be taken to implement them and identify what financial, staff and other resources will be needed to achieve success.

- *Develop and incorporate performance measures*. The objectives identified in the strategic planning process should be measurable so that progress toward their accomplishment can be evaluated. This requires the use of performance measures, particularly measures that assess efficiency, effectiveness and quality of service or program delivery.

- *Obtain formal approval of the plan*. The governing body of a jurisdiction should formally approve a strategic plan so that it can provide guidelines for the development of the budget and other financial plans.

- *Implement the strategic plan*. Once the strategic plan is approved, it then must be implemented with the active participation of all relevant stakeholders within the organization.

- *Monitor progress.* Progress toward the goals articulated in the strategic plan should be monitored and evaluated at regular intervals.

[15] This discussion is drawn from the Government Finance Officers Association. Recommended Budget Practice on the Establishment of Strategic Plans (Adopted 2005).

It is a best practice that all governments develop and implement a strategic plan. Such a plan includes financial planning elements such as a long term financial plan. In fact, the development of the financially-oriented plans presupposes that a strategic plan has been formulated in some fashion.

Because the comprehensive nature of a strategic plan means that it also includes broader programmatic elements, a recommendation of a statutory requirement for strategic plans is not within the purview of this report. The financial planning techniques listed in this report, however, are essential elements of a financial accountability structure. Therefore, it is our view that they should be statutorily required.

Best Practices and Recommended Practices in Strategic Planning

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) have developed best practices in capital improvement planning. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) also has developed several recommended practices in this policy area. A summary of the key recommendations from these institutions follows.

1. Develop a Multi-Year Strategic Plan

   All governments should develop a clearly written, multi-year strategic plan to provide a long term perspective on service and program delivery. The strategic plan will establish a framework that permits clear links between an organization's goals and its ultimate allocation of resources. It should address long term programmatic and financial goals, be reviewed on a regular basis and approved by the governing body.

   (See NACSLB Recommended Practice 3.1: Identify Broad Goals, NACSLB Recommended Practice 7.1 Develop Strategies to Facilitate Attainment of Program and Financial Goals, Government Finance Officers Association, Recommended Budget Practice on the Establishment of Strategic Plans – 2005, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Management Structures.)[16]

2. Provide Opportunities for Stakeholder Input into Strategic Planning Process

   Stakeholders, including elected officials and citizens, should have opportunities to provide input into the development of the strategic plan. These opportunities could include participation in citizen advisory committees, public forums and/or hearings prior to adoption of the plan.

   (See NACSLB Recommended Practice 3.2: Disseminate Goals and Review with Stakeholders.)

3. Make Strategic Plan Publicly Available

[16] See Point 9 of the Management Structures Best Financial Management Practices Guidelines for School Districts, p. 4. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

Strategic plans should be widely disseminated. They should be published on government Web sites and included in planning and other public documents.

(See NACSLB Recommended Practice 3.2: Disseminate Goals and Review with Stakeholders, the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices, Management Structures.)[17]

4. Require Formal Approval of Strategic Plan by School District Board of Trustees

   The strategic plan should be formally approved by the governing body of the government. It is imperative that elected officials be fully aware of the strategic direction of the organization they oversee so that they can evaluate progress toward organizational goals and make rational resource allocation decisions.

   (See Government Finance Officers Association, Recommended Budget Practice on the Establishment of Strategic Plans – 2005.)

[17] See Point 9 of the Management Structures Best Financial Management Practices Guidelines for School Districts, p. 4. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

BUDGETING

The budget is a document that outlines how a government intends to meet its financial goals for a given fiscal year. It is both an important planning tool for governments and a means by which governments communicate their plans and policies to stakeholders. This report examines three aspects of the budgeting process:

1. Budget Format
2. Performance Measures for Support Service
3. Public Disclosure

Budget Format

A budget's format should facilitate public understanding of a government's priorities, its financial condition, its financial strategies for meeting program goals, and its ability to attain objectives or meet challenges outlined in long-term planning documents like capital budgets, long-term financial plans, and strategic plans.

Effective budget formats enable governments to achieve the following goals:

- Clearly specify available resources
- Describe the allocation of funds for anticipated expenditures and contingencies
- Explain the effects of policy decisions on finances and on the attainment of program goals
- Explain key financial assumptions
- Compare financial performance over time
- Relate annual operating goals to long-term capital and strategic plans
- Communicate budgetary controls, policies, and processes
- Describe performance measures and their use in making personnel, staffing, and other planning decisions

The Illinois School Code and the Illinois State Board of Education (ISBE) enumerate detailed requirements for the completion of an annual budget. These requirements (which are listed in the "State of Illinois Requirements" section below) primarily pertain to the specific data that the budget must contain. In this respect, ISBE's operating budget requirements are in substantial compliance with Government Finance Officers Association (GFOA) recommendations for best practices. The Best Practices and Recommended Practices section below describes budgetary policies that are not currently mandated by Illinois law or by ISBE.

Best Practices and Recommended Practices for Budgeting Policies

The Government Finance Officers Association (GFOA) and the Association of School Business Officials International (ASBOI) has developed descriptions of best practices in budgeting policies. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) and the Office of the New York State Comptroller have developed several recommended practices in this policy area. A summary of the key recommendations for best practices is as follows:

1. <u>Require a "User Friendly" Executive Summary</u>

   School district budgets should be required to produce a "user friendly" Executive Summary that highlights important information contained in the budget or essential for understanding the budget. This summary may either be produced as a stand-alone document or as an introduction to the budget. While some school districts produce budgets with clear and informative Executive Summaries, many districts produce only line item budgets that do not effectively communicate the implications of policy decisions to public stakeholders. An Executive Summary comparable to the Manager's Discussion and Analysis (MD&A) section at the beginning of an audited financial statement would significantly improve the ability of elected officials and the public to grasp a school district's priorities, financial condition, and financial plans. The features contained in an Executive Summary should include:

   a) *Statement of major school district goals and objectives*: The Executive Summary should contain a clear statement of the district's financial and service goals and objectives.

   b) *Discussion of significant factors and trends affecting the budget*: The Executive Summary should contain a description of important financial pressures and significant changes in expenditures for particular objects or programs that have affected the district's budget. District management should also identify trends, such as school district enrollment changes or personnel cost increases, that have had a strong effect on the district's budget over time.

   c) *Description of the budget process*: District management should provide a description of the process and policies used to assemble the budget.

   d) *Walk-up and Walk-down*: If the district has had to close a projected gap between revenues and expenditures, the budget should include a clear description of the reasons for this gap and the steps taken to eliminate it.

   e) *Overview of revenues and expenditures for all funds*: Using both clear prose and relevant figures or charts, the Executive Summary should state the budget revenues and expenditures aggregated by fund.

   f) *Explanation of significant financial and demographic trends*: District management should identify the budgetary and demographic trends and, using both prose and relevant figures or charts, describe these trends. Between three and five years of financial trend data should be presented. The explanation of financial trends should include charts indicating district expenditures by object for all funds.

g) *Three- to five- year budget forecast*: The Executive Summary should include both prose and relevant figures or charts describing the revenues and expenditures that the district anticipates for the succeeding three, four, or five years.

h) *Student enrollment trends and forecasts*: Management should state the district's enrollment for the preceding five years and its anticipated enrollment for the succeeding five years.

i) *Chart quantifying the number of personnel by type and discussion of personnel changes*: The Executive Summary should contain a chart that allows the public to easily identify both the total number of district employees and the number assigned to particular functions (i.e., teachers, administrators, janitors, bus drivers, cafeteria workers, etc.). The district should also provide a clear prose description of the rationale for increases or decreases in the number of employees.

j) *Relevant performance statistics*: District management should use prose and relevant charts or figures to summarize the results of performance measurements used by the district.

(See Denny G. Bolton and W. Gary Harmer, *Standards of Excellence in Budget Presentation* (Reston: Association of School Business Officials International, 2000); also based on The Civic Federation's expertise in reviewing government finance.)

2. <u>Present an Organizational Chart</u>

District management should present a chart in the budget that shows the organizational structure of district management and identifies both elected school board members and the school district's top-level administrative personnel.

(See Denny G. Bolton and W. Gary Harmer, *Standards of Excellence in Budget Presentation* (Reston: Association of School Business Officials International, 2000); also based on The Civic Federation's expertise in reviewing government finance.)

3. <u>Explain Formal Financial Policies</u>

District management should describe in clear prose the formal financial policies adopted by the school district board of trustees, including policies on financial planning, revenues, expenditures, debt capacity and issuance, debt management, capital asset management, and reserve or stabilization funds.[18]

(See Shayne Kavanagh and Wright Anderson Williams, *Financial Policies: Design and Implementation* (Chicago: Government Finance Officers Association, 2004).)

[18] For a complete list of the formal financial policies that The Civic Federation recommends elected school boards should adopt, see the Formal Financial Policies section of this report, p. 21.

4. Include Long Term Financial Plan or a Summary Thereof

   Using long term financial plans in the preparation of operating budgets enables governments to allocate resources to core services and programs in a consistent manner by making gradual adjustments to program expenditures as required. Effective descriptions of how future plans and projections impact an annual budget also help stakeholders to understand policy decisions. School districts should either include their long term financial plan or provide a summary thereof in the district budget.

   (See Shayne Kavanagh and Wright Anderson Williams, *Financial Policies: Design and Implementation* (Chicago: Government Finance Officers Association, 2004).)

5. Include Capital Improvement Plan or a Summary Thereof

   School districts should either include their capital plan or provide a summary thereof in the district budget.

   (See Shayne Kavanagh and Wright Anderson Williams, *Financial Policies: Design and Implementation* (Chicago: Government Finance Officers Association, 2004).)

State of Illinois Requirements

State law requires that all Illinois school districts submit budgets to ISBE using a school district budget form designed by ISBE. ISBE makes this form available as a Microsoft Excel 2002 workbook through its website. This form requires school districts to:

1. Estimate receipts and revenues by source and by fund.

2. Estimate disbursements and expenditures by function (i.e., regular programs, special education programs, bilingual programs, etc.), by object (i.e., salaries, employee benefits, purchased services, etc.), and by fund.

3. Stipulate the date on which a public budget hearing was held, the date on which the budget was adopted by the school board, and which school board members voted for and against the budget.

4. Estimate the funds that will be allocated specifically to pay for administrative services.

ISBE publishes a guide, "Mechanics of a School District Budget: A Guide to Understanding the Illinois School District Budget Process" (March 2005), that is designed to assist districts in the preparation of their annual budgets.[19]

[19] Information on ISBE format requirements for school district budgets was drawn from this guide, which is available on the ISBE website at http://www.isbe.net/sfms/pdf/mechanics.pdf.

Comparison: Best or Recommended Practices v. State of Illinois Requirements

BUDGET FORMAT CHECKLIST	
1. Require a "User Friendly" Executive Summary	No
Require that the Executive Summary include each of the following:	
a) Statement of Major School District Goals and Objectives	No
b) Discussion of Factors and Trends Affecting the Budget	No
c) Description of the Budget Process	No
d) Walk-Up and Walk-Down	No
e) Overview of Revenues and Expenditures for All Funds	No
f) Explanation of Significant Financial and Demographic Trends	No
g) Three- to Five-Year Budget Forecast	No
h) Student Enrollment Trends and Forecasts	No
i) Chart Quantifying the Number of Personnel by Type and Discussion of Personnel Changes	No
j) Relevant Performance Statistics	No
2. Present an Organizational Chart	No
3. Explain Formal Financial Policies	No
4. Include Long-Term Financial Plan or a Summary Thereof	No
5. Include Capital Improvement Plan or a Summary Thereof	No
6. Specify Financial Data to be Included in District Budgets	Yes
7. Create a Guide to Assist in the Production of District Budgets	Yes

Recommendations

Based on a review of best and recommended practices in budget formats, it is recommended that the following budget format guidelines be adopted by the State of Illinois in statute.

1. Require school districts to include a “user friendly” Executive Summary section in their budgets and/or as a stand alone document. The Executive Summary should contain each of the following components:

    - A statement of school district major goals and objectives.
    - A discussion of major financial factors and trends affecting the budget such as changes in revenues, enrollment and debt.
    - A description of the budget process.
    - An overview of revenues and expenditures for all funds (including 3-5 years of prior trends).
    - An explanation of significant financial and demographic trends.
    - A “walk up” that explains the reasons for a budget deficit and a “walk down” that explains how the deficit was closed.
    - A budget forecast for 3-5 years in the future.
    - Student enrollment trends, including a future forecast of enrollment.
    - A chart showing the number of personnel by type as well as a narrative discussion of personnel changes.
    - A discussion and graphic depiction of changes in debt burden.
    - Relevant performance statistics.

2. Require school districts to present an organizational chart identifying elected school board officials and top-level school district administration in their budgets.

3. Require school districts to provide either their complete formal financial policies or a summary thereof in their budgets.

4. Require that school districts include either their long term financial plan or a summary thereof in their budgets.

5. Require that school districts include either their capital plan or a summary thereof in their budgets.

Evaluation: Performance Measures for Support Service Functions

Performance measures are quantitative or qualitative indicators of program or service outputs and outcomes. They are effective means of monitoring, measuring and evaluating departmental and program performance over time. They help track progress toward meeting intended programmatic goals and help assess whether programs are making an efficient use of resources. Evaluating and reporting on program results helps keep policymakers and taxpayers alike informed about actual results compared to expectations.[20]

There are four types of performance measures:

- **Workload measures**, which provide counts of a service performed or a good delivered

- **Efficiency measures**, which provide information on how many resources are consumed in delivering a good or service, such as the cost per unit or output per employee.

- **Effectiveness measures**, which assess how well a program has met its goals by showing planned output versus actual output.

- **Quality measures**, which assess customer or constituent satisfaction with service delivery.

Producing reams of performance measures that are not linked to goals or objectives, utilized to inform management decisions, or developed without the buy-in of management and staff can be costly and have limited efficacy. However, using a few well-chosen measures, particularly those measuring efficiency and effectiveness that are produced consistently and developed with the buy-in of staff, can be extremely useful in assisting school districts and other governments to improve their management and operations.

Best Practices and Recommended Practices for Performance Measurement

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) have developed best practices for formal financial policies. In addition, the State of Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) also has developed several recommended practices in this area. A summary of the key recommendations of those practices that have the most direct application to school districts follows.

1. <u>Develop and Implement Performance Measures for Support Service Functions</u>

   All governments should develop and utilize performance measures that are linked to specific program goals and objectives. The measures adopted should be valid, reliable, and verifiable. A high performing performance measurement system includes measures that provide for comparisons of outputs and outcomes over time, are used for managerial decision making,

[20] See Recommended Practice 11.1 "Monitor, Measure, and Evaluate Program Performance," in National Advisory Council on State and Local Budgeting. *Recommended Budget Practices: A Framework for Improved State and Local Budgeting* (Chicago: GFOA, 1998).

are limited in number and are designed to help motivate staff to contribute in a meaningful way to organizational efficiency.

Performance measures specifically should be developed for support service functions. These types of functions include facilities management, food service and administration.

(See National Advisory Council on State and Local Budgeting Recommended Practice 6.4: Develop Performance Measures; GFOA Recommended Practice: Performance Management: Using Performance Measurement for Decision Making -2002 and- Updated Performance Measures -1994; the State of Florida Office of Program Policy Analysis and Government Accountability, Best Financial Management Practices.)[21]

2. <u>Make Performance Measures Publicly Available</u>

   Performance measures should be included in budget documents and/or related financial management documents so that elected officials, citizens and other stakeholders can assess progress toward meeting program goals.

   (See National Advisory Council on State and Local Budgeting Recommended Practice 6.4: Develop Performance Measures; GFOA Recommended Practice: Performance Management: Using Performance Measurement for Decision Making -2002 and- Updated Performance Measures -1994.)

State of Illinois Requirements

The State of Illinois does not require school districts to develop and implement performance measures.

Comparison: Best or Recommended Practices v. State of Illinois Requirements

PERFORMANCE MEASUREMENT CHECKLIST	
Best or Recommended Practice	**State of Illinois Requirement**
1. Develop and Implement Performance Measures for Support Service Functions	No
2. Make Performance Measures Publicly Available	No

[21] See Point 7 (Food Service Operations – Performance and Accountability) on pp. 58-59, and Point 20 (Transportation) on p. 55. Florida Office of Program Policy Analysis and Government Accountability (OPPAGA). *Best Financial Management Practices.* See www.oppaga.state.fl.us/school_districts/bestprac/practices.html.

Recommendations

Based on a review of best and recommended practices on performance measurement it is recommended that the following school district financial accountability measures be adopted by the State of Illinois in statute.

1. Require that school districts develop and implement performance measures for support service functions such as administration, food service and transportation.
2. Make performance measures publicly available in the budget document and/or other financial management reports.

Public Disclosure

In order to understand and provide informed commentary on a government's budget, citizens and stakeholders must have adequate access to the budget document and must have sufficient time after the tentative budget's release to evaluate it before the elected school board holds its public budget hearing.

The requirements in the Illinois School Code for making the budget available and for allowing sufficient time between the tentative budget's release and the district's budget hearing are substantially compliant with the Civic Federation's recommendations for best practices in public disclosure. These requirements are described in the "State of Illinois Requirements" section below.

Best Practices and Recommended Practices for Performance Measurement

Based on its expertise in reviewing government finance, the Civic Federation has developed descriptions of best practices in public disclosure. The Best Practices and Recommended Practices section below describes budgetary policies that are not currently mandated by Illinois law or by ISBE.

1. <u>Require that School Districts Post "User Friendly" Executive Summaries on the Web</u>

   In order to understand the financial situation and policies of a school district, both the public and school district officials require a broader perspective than can be attained by reviewing a line-item budget. School districts should therefore be required to post on the worldwide web a "user friendly" Executive Summary that meets the criteria described in the Budget Format section above. This Executive Summary may be presented as a stand-alone document or as the introductory section of the school district budget.

   (The Civic Federation, based on its expertise in reviewing government finance.)

State of Illinois Requirements

Illinois law requires school districts to post their budgets on the worldwide web and to make their tentative budgets publicly available 30 days before a public budget hearing is held by the elected school board. (The budget for Chicago Public Schools need only be made available 15 days before the budget hearing.)

Comparison: Best or Recommended Practices v. State of Illinois Requirements

PUBLIC DISCLOSURE CHECKLIST	
1. Require that Districts Post Executive Summaries on the Web	No
2. Require that Districts Post Budgets on the Web	Yes
3. Require that the Budget be Released Ten Working Days Before Public Review Hearing	Yes

Recommendations

Based on a review of best and recommended practices on public disclosure, it is recommended that the State of Illinois require by statute that school districts be required to post "user friendly" Executive Summaries of their budgets on the worldwide web.

FINANCIAL MANAGEMENT TRAINING FOR SCHOOL BOARD MEMBERS

Elected members of School District Boards of Trustees are charged with overseeing complex financial operations. However, many members do not have expertise or training in budgeting, financial planning, accounting or other aspects of financial management. Therefore, they must rely heavily on the advice of school business officials and other administrators. In most instances, this process works well. However, it often leads to a situation in which there is a decided imbalance of information and understanding between the elected leadership and administrators.

The imbalance of information between elected officials and administrators is very problematic. School board members have a fiduciary responsibility to act in the best interests of their constituents. However, they may be voting on fiscal issues they do not clearly comprehend. They may not even know what questions to ask their budget and finance staffs in exercising their oversight duties. This lack of understanding can lead to school districts making unfortunate and costly choices or even to fiscal improprieties. In response to highly publicized financial scandals involving embezzlement of millions of dollars in funds by local school district officials, New York State recently approved legislation that strengthened internal control procedures and required mandatory training for school board members in financial management issues.[22]

Recommended Practice in Financial Management Training for School Board Members

Require Financial Management Training for all Elected School Board Members

In order to fully fulfill their fiduciary responsibilities, all school board members must complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities. The training must be completed within a year of their election and can be provided by a Illinois State Board of Education approved trainer.

(See New York State School District Accountability Initiative.)[23]

State of Illinois Requirements

The State of Illinois currently does not require elected School Board Trustees to undergo financial management training.

[22] Office of the New York State Comptroller. *School District Accountability Initiative: 2005 Annual Report.* December 2005. p. 3.
[23] Office of the New York State Comptroller. *School District Accountability Initiative: 2005 Annual Report.* December 2005. pp. 7-9.

Comparison: Recommended Practices vs. State of Illinois Requirements

MANDATORY FINANCIAL MANAGEMENT TRAINING FOR SCHOOL BOARD MEMBERS	
Best or Recommended Practice	**State of Illinois Requirement**
Require Financial Management Training for all Elected School Board Members	No

Recommendations

The State of Illinois should adopt by statute the following recommendations:

1. The State of Illinois should require all elected school board members complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities.

2. The training must be completed within a year of their election and could be provided by an Illinois State Board of Education approved trainer.

FINANCIAL MANAGEMENT ACCOUNTABILITY OVERSIGHT

The financial management accountability reforms proposed in this report are extensive and include many aspects of the financial management process. In order to ensure that the reforms are implemented, it is recommended that they be enacted into law. Guaranteeing that the spirit and the letter of the law are followed would require a degree of monitoring and oversight from the Illinois State Board of Education.

Current State of Illinois Oversight

Currently, there is a degree of regulation and management by ISBE over individual school districts. ISBE requires the submission of annual financial reports from the state's school districts. The Board also regularly audits school district financial information. In the case of financially distressed schools, the Board exercises strong oversight powers.

The State Superintendent of Education may require a school district to provide fiscal information relevant to an investigation of its financial condition if:[24]

- The school district on the financial warning or watch list has failed to file an annual financial report, annual budget, deficit reduction plan or other financial information as required by law or

- A school district has been identified as being in serious financial difficulty in the district's annual audit or in other financial information.

A school district that the State Board of Education has certified as being in financial difficulty is required to develop, adopt and submit a financial plan with 45 days after the certification.[25] The district must report on compliance with the financial plan from time to time. The State Board of education also may review district operations and require the district to produce reports.

If the State Board determines the district has failed to comply with the financial plan, the Board may appoint a Financial Oversight Panel for the district.[26] The Financial Oversight Panel has the power to approve or reject the financial plans, budgets and contracts of the Board of a district in fiscal distress. The school district board must develop and adopt an initial financial plan for the remainder of the current fiscal year and then for two succeeding fiscal years. The plans must be approved by the Panel.[27]

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[24] 105 ILCS 5/1A-8

[25] This is the case for all districts other than the Chicago Public Schools District. If the Chicago District is found to be in financial difficulty, the State Board of Education is required to inform the Governor and the Mayor of Chicago.

[26] 105 ILCS 5/1A-8.

[27] 105 ILCS 5/1B-10.

Recommendations

To ensure that school districts adequately implement any or all of the financial management accountability reforms proposed in this report, it is recommended that the State of Illinois adopt by statute the following reforms:

1. An Office of State School District Financial Management Accountability within the Illinois State Board of Education should be created to monitor progress made by school districts in meeting the statutory requirements of approved reforms.

2. School districts failing to meet approved financial management reform standards within a reasonable, specified timetable would be placed under the direct oversight of the Office of State School District Financial Management Accountability.

3. School districts placed under State supervision would be required to develop a 3-year improvement plan to meet the reform standards.

4. ISBE would withhold funds from school districts failing to fulfill State financial management accountability requirements and would be empowered to remove and replace non-complying financial management administrators.

FUNDING SCHOOL FINANCIAL MANAGEMENT ACCOUNTABILITY REFORMS

This report recommends that the State of Illinois require school districts to implement the following types of structural and reporting reforms:

- Improved transparency of budget documents,
- Implementation of financial management performance measures,
- Strengthened internal controls of school district financial operations, and
- Implementation of planning processes for operations, finances and capital programming

Implementing these structural and reporting reforms in many instances will require school districts to hire additional management staff in the areas of budgeting and finance. As a result, there will be added administrative costs. These costs are reasonable in light of the benefits they will produce in ensuring a more transparent and accountable financial management system for Illinois school districts. However, it is recognized that additional expenses will impose an additional financial burden on school districts, many of which historically have experienced financial difficulties.

Recommendations

To defray the additional administrative costs of implementing the structural and reporting reforms contained in this report, it is recommended that the State of Illinois adopt by statute the following reforms:

1. A portion of any new revenues for elementary and secondary education should be earmarked for the purpose of providing funding for implementation of the new financial management accountability reforms. This funding requirement should be included in any school financing reform statute ultimately adopted.

2. The amount to be earmarked will be based on a review of estimated new administrative costs conducted under the direction of the Illinois State Board of Education.

3. The administrative funding amount and mechanism implemented should be reviewed every five years to determine its adequacy.

4. Periodic adjustments to the amount and method of funding administrative costs should made based on the five year review.

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Appendix One: State of Illinois School District Financial Reporting Requirements

The Illinois School Code and ISBE currently have two financial reporting requirements with which Illinois School Districts must comply:

1. A Budget
2. An Annual Financial Report

ISBE also requires that school districts calculate five financial indicators and include these measures in their Annual Financial Reports. ISBE uses these indicators to generate a School District Financial Profile for each district in order to gauge districts' financial health. The system that ISBE uses for evaluating these indicators is described below.

Budget

State law requires that all Illinois school districts submit budgets to ISBE using a school district budget form designed by ISBE. ISBE makes this form available as a Microsoft Excel 2002 workbook through its website. This form requires school districts to:

1. Estimate receipts and revenues by source and by fund.

2. Estimate disbursements and expenditures by function (i.e., regular programs, special education programs, bilingual programs, etc.), by object (i.e., salaries, employee benefits, purchased services, etc.), and by fund.

3. Stipulate the date on which a public budget hearing was held, the date on which the budget was adopted by the school board, and which school board members voted for and against the budget.

4. Estimate the funds that will be allocated specifically to pay for administrative services.

Annual Financial Report

School districts must also submit Annual Financial Reports (AFRs) to the Superintendent of their Educational Service Region on or before the October 15 that immediately follows the fiscal year's end. The Regional Office must forward district reports to ISBE by November 15 of that same year. (Chicago Public Schools submits its AFR directly to ISBE by February 15.)

District AFRs must be completed by an independent Certified Public Accountant. Like the school district budgets that are submitted to ISBE, the AFRs must also be completed using forms provided by ISBE. These forms require that school districts:

1. Report receipts and revenues by source and by fund.

2. Report disbursements and expenditures by function (i.e., regular programs, special education programs, bilingual programs, etc.), by object (i.e., salaries, employee benefits, purchased services, etc.), and by fund.

3. Report all short- and long term borrowing.

4. Include a schedule of capital outlay and depreciation.

5. Estimate per pupil operating expenditures and per capita tuition charges.

6. Report administrative costs.

7. Complete an Annual Federal Compliance Report.

The Service Region Superintendent is responsible for carrying out a district audit if the District fails to submit the completed AFR in time (or by a previously-granted extension deadline). The Service Region Superintendent is also authorized to withhold State funds from districts that do not file their reports on time. Regional Offices of Education must also maintain records that can be reviewed by an independent auditor selected by ISBE. Records for a given year must be in an auditable form by August 15 of the succeeding fiscal year, and Regional Offices' financial reports for that year must be completed by August 31. The audit report is presented to the Regional Office of Education Oversight Board at the first Board meeting following the audit's completion.

Financial Profile

ISBE creates a School District Financial Profile for each district, and assigns a score to each district based on five financial indicators reported in the district's AFR. The five metrics are as follows:

1. *Fund Balance to Revenue Ratio*: this metric is produced by dividing the ending fund balances by the revenues for the four operating funds (Education, Operations & Maintenance, Transportation, and Working Cash Fund).

2. *Expenditure to Revenue Ratio*: this metric is calculated by dividing total expenditures by the revenues for the operating funds (ISBE considers remaining fund balances in this metric, so that a district engaging in deficit spending is not penalized if it has sufficient fund balances to cover the expenditures).

3. *Days Cash on Hand*: this metric estimates the number of days a district could meet operating expenses if no additional revenues were received; it is calculated by dividing the total cash on hand and investments at the end of the fiscal year by the average daily operating expenditures for the district.

4. *Percent of Short-Term Borrowing Maximum Remaining*: this metric is calculated by subtracting the percentage of Tax Anticipation Warrants that remain outstanding at the end of the fiscal year form 100%.

5. *Percent of Long Term Debt Margin Remaining*: This metric is calculated by subtracting the percentage of outstanding long term debt at the end of the fiscal year from the school district's legal debt limit.

Using a standardized scale, ISBE assigns each district a score of 0, 1, 2, 3, or 4 points for each financial indicator. Then, ISBE weights these scores and generates a composite score on a scale form 0 to 4. A district that receives between 3.54 and 4.00 points is designated as having achieved "Financial Recognition," the highest category of financial strength. A district that receives between 3.08 and 3.53 points receives the "Financial Review" category, the next-highest category. "Financial Review" districts are monitored by ISBE for downward financial trends. Districts that receive between 2.62 and 3.07 points are placed on ISBE's "Financial Warning" list. Districts on this list are closely monitored and offered technical financial assistance. Lastly, districts that receive between 1.00 and 2.61 points are placed on ISBE's "Financial Watch" list. These districts are also monitored very closely and are offered technical assistance that includes but is not limited to financial projections, cash flow analysis, budgeting, personnel inventories, and enrollment projections.

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Appendix Two: Selected Best Practice Examples from Illinois School Districts

Hinsdale Township High School District 86 Fiscal Goals

Narrative Summary of Budget Highlights and Frequently Asked Questions (2005-6) for Evanston/Skokie School District 65

Narrative Summary of Tentative 2006-7 Budget Highlights Wheeling Community Consolidated School District 21

Narrative Summary of the Highlights of the 2006-7 Operating Budget for Hinsdale Township High School District 86

Financial Guidelines: Oak Park Elementary School District 97

Long Range Financial Plan 2005-6 through 2009-10 for Evanston/Skokie School District 65

Revenues and Expenditures: Anticipated FY06 to Projected FY09: Woodland School District 50

Executive Summary of the 2005-10 New Trier Township High School District Strategic Plan

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