

Department of Legislative Services
 Maryland General Assembly
 2004 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 894

(Senator Currie, *et al.*)

Budget and Taxation

Ways and Means and Appropriations

Education Fiscal Accountability and Oversight Act of 2004

This bill establishes procedures to ensure fiscal accountability of local school systems by requiring biannual financial reports, prohibiting school budget deficits, and providing for regular legislative audits. Failure to comply with certain fiscal accountability procedures would result in the withholding of State education funding.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: General fund expenditures could increase by \$688,200 in FY 2005. The FY 2005 State budget includes \$400,000 to cover a portion of the costs for the Office of Legislative Audits (OLA). Future year expenditures reflect annualization and inflation. Revenues would not be affected.

(in dollars)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	688,200	854,200	899,000	946,700	1,016,500
Net Effect	(\$688,200)	(\$854,200)	(\$899,000)	(\$946,700)	(\$1,016,500)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local school systems could comply with the additional reporting requirements with existing resources. It is assumed that local school systems are already providing regular financial reports to their local boards of education.

Small Business Effect: None.

Analysis

Bill Summary: The State Superintendent of Schools and the Maryland State Department of Education (MSDE) must monitor the financial status of each local school system and report their findings on a biannual basis to the Governor and the General Assembly. Each local school superintendent or chief executive officer must file a biannual report on the financial status of the local school system with the State Superintendent and county governing body and attest to the accuracy of each biannual report when the report is submitted. The reports must be submitted by April 30 and December 31 of each fiscal year.

Reporting of Operating Deficits

Local school systems are prohibited from carrying a deficit as reported in the annual audit. Upon determining that a local school system has a deficit, the State Superintendent must immediately notify the Governor, the General Assembly, the Department of Legislative Services, and the county governing body and require the local school system to: (1) develop and submit for approval a corrective action cost containment plan within 15 days; (2) file monthly status reports with the State Superintendent and county governing body demonstrating actions taken to close the deficit and the effect of the actions taken on the deficit; and (3) include information on the corrective action cost containment plan, actions taken to close the deficit, and status of the deficit in the biannual financial status reports filed with the State Superintendent and county governing body. The State Superintendent must include this information in a quarterly report submitted to the Governor and the General Assembly. The Office of Legislative Audits (OLA) is permitted to obtain financial information from a local school system that has a deficit.

The Baltimore City Board of School Commissioners must eliminate the general fund deficit no later than June 30, 2006.

Penalties for Noncompliance

If a local school system fails to comply with the specified requirements, the State Superintendent, with the approval of the State Board of Education, must notify the State Comptroller, who must then withhold 10% of the next installment and each subsequent installment due the local school system from the General State School Fund until the State Superintendent notifies the Comptroller that the local school system is in full compliance with the specified requirements.

Legislative Audits

With the approval of the Executive Director of the Department of Legislative Services, the Legislative Auditor must appoint professional staff to conduct an audit of each local school system to evaluate the effectiveness and efficiency of the system's financial management practices. The scope, measurements, and process used in the financial management audits must be approved by the Joint Audit Committee. OLA must conduct by December 1, 2004 a centralized audit of the mater plans to determine overall compliance with State requirements. The audit results must be submitted to the Joint Audit Committee and other specified committees. Each local school system would be audited once over the next six years. Local school systems with a negative fund balance in the general fund of 1.0% or more in either of the prior two fiscal years must be included in the first group of audits. Thereafter, OLA must give priority to local school systems that have failed to comply with any of the provisions of the bill.

Due to the new financial management audit of local school systems, the bill repeals the requirement that OLA review any audit report prepared under the authority of the local boards of education, but provides that the letter of recommendation included in a local board of education audit is a matter of public record.

Comprehensive Master Plans

The deadline for the submission of the annual updates to the local school system's comprehensive master plan is extended from July 1 to August 15. Local school systems must include budget and expenditure information in the updates. The State Superintendent must review the alignment of a local board's budget and master plan and report to the Governor, county governing body, the county board of education, and the General Assembly on the results of the review.

The bill extends the master plan update filing deadline and adds other reporting requirements for the Baltimore City Public School System.

Current Law: Local boards of education must provide for an annual audit of their financial transactions and accounts by a certified public accountant. Within three months after the close of the fiscal year, the results of the annual audit must be submitted to the State Superintendent of Schools; the county fiscal authority; the Joint Audit Committee of the General Assembly; the Senate Budget and Taxation Committee; the Senate Education, Health, and Environmental Affairs Committee; the House Appropriations Committee; and the House Committee on Ways and Means. The county commissioners or county council may conduct an audit of the local school system using auditors

employed by the county. In addition, performance audits, semi-annual fiscal status reports, and other reporting requirements are specified in statute.

Background: Funding for public schools remains a high priority for both State and local governments. Public school funding accounts for 48% of total county expenditures and 33% of State general fund expenditures. Local school systems will receive \$7.9 billion in funding in fiscal 2004. Of this amount, \$4.2 billion or 52.4% is local funds, \$3.3 billion or 41.4% is State funds, and \$491.3 million or 6.2% is federal funds. Over the next three fiscal years, State funding for public schools will increase significantly due to the enactment of the Thornton legislation (Chapter 288 of 2002).

State education aid is among the fastest growing components of the State general fund budget. From fiscal 2005 to 2008, State education aid will increase by 9.4% annually compared to 8.1% for entitlements, 4.6% for State operations, and 3.1% for noneducation local aid. State education aid accounted for 26% of State general fund expenditures in fiscal 2002 and 33% in fiscal 2005. By fiscal 2008, State education aid will account for 36% of general fund expenditures.

With this increased State and local financial support comes concern that local school systems may not have the appropriate mechanisms in place to ensure that the additional funds are being spent appropriately. Two local school systems (Baltimore City and Prince George's County) indicate the existence of deficits in their operating budgets.

On February 10, 2004, school officials from Prince George's County briefed members of the Senate Budget and Taxation Committee and the House Appropriations Committee on the existence of deficits in the school system's budget for fiscal 2003 and 2004. Based on information presented at the hearing, the Prince George's County School System ended fiscal 2003 with a \$15.3 million deficit which was carried over into fiscal 2004. In addition, the school system anticipates a \$33.2 million shortfall in fiscal 2004. The school system's Chief Executive Officer outlined a plan that eliminates the deficits in fiscal 2004 by reducing programs and services by \$82 million.

The fiscal crisis in Baltimore City is more severe with the school system becoming insolvent absent a financial bailout by the city or State government. An audit of the Baltimore City School System shows an accumulated deficit of \$58 million.

State Fiscal Effect: General fund expenditures could increase by \$688,200 in fiscal 2005 and \$1.0 million by fiscal 2009. This reflects the cost for nine additional positions at OLA for conducting financial management audits of local school systems and two additional positions at MSDE for reviewing financial reports.

Administrative Costs – Legislative Audits

Pursuant to this legislation, OLA is required to audit each local school system over a six-year period. Each audit would include an examination of the financial management practices of each local school system relative to best practices and prudent internal controls. Similar type audits are currently conducted in Arizona, Florida, and Texas. The personnel resources needed for each audit, depending on the school system’s size and other factors, would range from 200 to 600 personnel days for each audit.

Based on these assumptions, OLA would need nine additional professional auditors. The annual salary and fringe benefit costs for these nine positions (excluding the 25% reduction for start-up costs) would be approximately \$640,000. Other operating expenditures include travel for overnight out-of-town assignments, the addition of two State vehicles and related operating costs, training costs, computers, and other supplies. In the first year, these costs would total approximately \$93,900. The following table shows the projected costs within OLA for the additional audit requirements for selected years.

	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2009</u>
Salaries and Benefits	\$480,900	\$656,300	\$773,200
Other Expenses	<u>93,900</u>	<u>56,800</u>	<u>77,500</u>
Total Expenditures	\$574,800	\$713,100	\$850,700

Administrative Costs – MSDE

Currently MSDE reviews the annual financial statements of each local school system with approximately one staff position. Expanding this responsibility to include review of financial reports and the alignment of local school systems’ budget and master plans would require two additional staff auditors. Accordingly, general fund expenditures within MSDE could increase by \$113,400 in fiscal 2005, which reflects a 90-day start-up delay. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses as illustrated below:

	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2009</u>
Salaries and Fringe Benefits	\$97,100	\$132,600	\$156,600
Office Equipment	9,500	0	0
Ongoing Operating Expenses	<u>6,800</u>	<u>8,600</u>	<u>9,200</u>
Total Expenditures	\$113,400	\$141,200	\$165,800

Future year expenditures reflect: (1) salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: None.

Cross File: HB 1505 (Delegates Conway and Hixson) – Ways and Means and Appropriations.

Information Source(s): Maryland State Department of Education, Department of Legislative Services (Office of Legislative Audits)

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Analysis by: Hiram L. Burch Jr.

Direct Inquiries to:
(410) 946-5510
(301) 970-5510