HB 1505

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 1505 (Delegates Conway and Hixson)
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 quarterly 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 $1.7 million in FY 2005. 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	1,711,500	2,150,900	2,262,600	2,434,000	2,508,500
Net Effect	($1,711,500)	($2,150,900)	($2,262,600)	($2,434,000)	($2,508,500)

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 quarterly basis to the Governor and the General Assembly. Each local school superintendent or chief executive officer must file a quarterly report on the financial status of the local school system with the State Superintendent and attest to the accuracy of each quarterly report when the report is submitted.

Reporting of Operating Deficits

Local school systems are prohibited from carrying an operating deficit as reported in the annual audit. Upon determining that a local school system has a deficit of any amount, the State Superintendent must immediately notify the Governor and the General Assembly and require the local school system to: (1) develop a corrective action cost containment plan within 15 days; (2) file monthly status reports with the State Superintendent 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 quarterly financial status reports filed with the State Superintendent. The State Superintendent must include this information in the quarterly reports submitted to the Governor and the General Assembly.

Penalties for Noncompliance

If a local school system fails to comply with the specified requirements, the State Superintendent 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 a management and financial practices audit of each local school system. This audit must take place at least once every three years. The audit must include a review of: (1) the adequacy of the local school system's master plan and whether the master plan contains sufficient detail to allow a determination that the additional education aid has been used in a manner consistent with the master plan and for purposes that will achieve identifiable and measurable goals in the master plan; and (2) the use of the additional State aid and the extent to which the funds have been used to provide improvements in the direct educational services and programs for students in the local 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 $1.7 million in fiscal 2005 and $2.5 million by fiscal 2009. This reflects the cost for 25 additional positions at the Office of Legislative Audits (OLA) for conducting management and financial practices audits of local school systems and two additional positions at MSDE for reviewing quarterly financial reports.

Administrative Costs – Legislative Audits

Pursuant to this legislation, OLA is required to audit each local school system once every three years. Each audit includes a management and financial practices audit and an audit of the school system's master plan. The management and financial practices audit would consist of 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. The scope of the master plan audits would consist of determining whether the plans meet State legal requirements and whether additional State education aid provided under the Thornton legislation was used consistent with the plans and achieved stated goals. Aspects of this audit would be similar to OLA's audits of the State's *Managing for Results* data. The personnel resources needed for this audit would total 150 personnel days for each audit.

Based on these assumptions, OLA would need 25 additional professional auditors, of which 18 would conduct the management and financial practices audits and 7 would conduct the master plan audits. The annual salary and fringe benefit costs for these 25 positions (excluding the 25% reduction for start-up costs) would be approximately $1.8 million. Other operating expenditures include travel for overnight out-of-town assignments, the addition of four State vehicles and related operating costs, training costs, computers, and other supplies. In the first year, these costs would total approximately $246,000. The following table shows the projected costs within OLA for the additional audit requirements for selected years.

	FY 2005	FY 2006	FY 2009
Salaries and Benefits	$1,351,700	$1,844,200	$2,172,100
Other Expenses	246,400	165,500	170,600
Total Expenditures	**$1,598,100**	**$2,009,700**	**$2,342,700**

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 the review of quarterly financial reports 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:

	FY 2005	FY 2006	FY 2009
Salaries and Fringe Benefits	$97,100	$132,600	$156,600
Office Equipment	9,500	0	0
Ongoing Operating Expenses	6,800	8,600	9,200
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: SB 894 (Senator Currie, *et al.*) – Budget and Taxation.

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

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ncs/jr

Analysis by: Hiram L. Burch Jr.

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