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STATE OF CALIFORNIA GEORGE DEUKMEJIAN, *Governor*

**COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY**

1127 - 11th Street, Suite 550, (916) 445-2125
Sacramento 95814

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Honorable George Deukmejian
Governor of California

Honorable David A. Roberti
President pro Tempore of the Senate
and Members of the Senate

Honorable James Nielsen
Senate Minority Floor Leader

Honorable Willie L. Brown, Jr.
Speaker of the Assembly
and Members of the Assembly

Honorable Patrick Nolan
Assembly Minority Floor Leader

Dear Governor and Members of the Legislature:

The Commission on California State Government Organization and Economy, also known as the Little Hoover Commission, is extemely distressed at the failure of public officials to recognize the pending fiscal crisis in California's kindergarten through grade 12 (K-12) public school system and to take actions to avert it. This crisis is the result of a continuing lack of financial accountability and responsibility in the State's K-12 educational system and the drastic impact that the Gann spending limitation may have on the level of school funding in the upcoming year.

During the last four years, the State has increased the funding for the K-12 public school system by an additional $4.9 billion in an effort to improve the quality of education in California. However, this dramatic increase in educational funding has not been accompanied by a concomitant increase in the State's efforts to improve its enforcement and control over educational spending. Although the Commission recognizes that in recent years some necessary improvements have been made to gather more financial information from school districts, the Commission is concerned that elected officials have made virtually no effort to create direct accountability for the more than $15 billion the State spends on its K-12 public education system.

Moreover, the State of California is now butting its head up against the spending ceiling imposed by Proposition 4, the Gann spending limitation. It is projected that the State's budget may face as much as a $900 million funding shortfall for continuing current programs in fiscal year 1987-88 due to the Gann spending limitation. Therefore, the Commission believes it is time for the State to wake up to the harsh reality that Proposition 4 may severely undermine the quality of education in California unless the State increases its enforcement and control over educational expenditures and holds the

Superintendent of Public Instruction and school district financial managers directly accountable for spending.

This letter provides background information on the Commission's continuing concern for financial accountability and responsibility in K-12 public education, additional information regarding increases in State funding levels, and some analysis of the disappointing efforts in recent years to shore up the financial management systems for K-12 public education. The final section of the letter presents the Commission's recommendations for improving the financial accountability, reporting and control within the State's K-12 public education system.

COMMISSION'S LONG-STANDING CONCERN FOR FINANCIAL ACCOUNTABILITY AND RESPONSIBILITY IN K-12 EDUCATION

During the past decade, the Commission has demonstrated a continuing concern regarding the need for increased accountability for the funding of the State's K-12 public school system. This concern has been evidenced by numerous public hearings and studies that have examined the organization and financial responsibilities of the agencies involved in the K-12 system, as well as the specific financial practices of individual agencies. These studies have identified millions of dollars of unnecessary expenditures due to inefficient and non-economical practices at the State, county, and local school district level within the State's K-12 public school system. The Commission believes that the primary factor that has contributed to the unnecessary and wasteful expenditure of educational funds is the lack of a viable system of financial accountability and control for K-12 public education funding.

More recently, the Commission's review of the use of lottery funds by school districts has raised additional concerns about the financial accountability of local education agencies. This review showed that once districts receive lottery funds, they can co-mingle lottery funds with general fund monies. This makes it very difficult, if not impossible, to determine how lottery funds are spent. Moreover, no sanctions or penalties exist to discourage school districts from misusing these funds.

The State's present system for overseeing and controlling the use of K-12 public school system funds has no central focal point of responsibility. Currently, the responsibility for financial accountability is dispersed among the State Department of Education, the State Controller's Office, county offices of education, and local school districts. In fact, there is not one department or agency which is in charge or is fully accountable for educational spending.

The current system of financial accountability relies heavily on annual financial audits of school districts that are performed by public accounting firms. In addition, the Department of Education, the State Controller's Office, and the Auditor General's Office occasionally conduct audits of certain aspects of the State's K-12 funding. The Commission believes that the numerous agencies involved in the oversight of State educational funding results in confusion, wasted resources, and promotes a breakdown in accountability and control in the very system that is designed to foster more efficient and economical use of funds.

## INCREASES IN STATE FUNDING FOR K-12 EDUCATION WITHOUT COMMENSURATE INCREASES IN FINANCIAL ACCOUNTABILITY

Since the passage of Proposition 13 in 1978, the State of California has assumed the major responsibility for funding the K-12 public school system. Presently, the State provides more than 70 percent of the funding for K-12 public education. In 1983, the Legislature enacted Senate Bill 813, Chapter 498, Statutes of 1983, which hallmarked the beginning of a major educational reform effort to improve the quality of education in California's schools. This measure has also been accompanied by an infusion of an additional $4.9 billion in funding for the State's K-12 public school system in the past four years. Thus, the State's expenditures for K-12 education will be an estimated $15.3 billion in fiscal year 1986-87. This represents a 32 percent increase in funding since 1983.

While the Commission appreciates the efforts of the Governor, the Legislature, and the Superintendent of Public Instruction to improve the quality of K-12 education, the Commission believes that the State has made a major investment of additional funding in K-12 education without ensuring a commensurate level of financial accountability. Thus, the State does not have adequate assurance that the increased money it is providing for K-12 education is being well-spent.

## STATE'S INSUFFICIENT EFFORTS TO INCREASE FINANCIAL ACCOUNTABILITY AND RESPONSIBILITY IN K-12 EDUCATION

The Commission recognizes that at the same time that California has been instituting major education reforms in K-12 public education, the State has made some efforts to increase the financial accountability and responsibility in its educational system. Regrettably, these efforts have not been sufficient to provide the level of accountability that is warranted considering the size of the State's investment in education.

Senate Bill 813 established the California Commission on School Governance and Management to review the efficiency and effectiveness of the governance and management structure within the State's K-12 system. Specifically, it examined the roles and responsibilities of the various units of government involved in the system and made recommendations to improve the system. Although the Legislature recognized that there was a need for a review of the management and governance structure within the K-12 system due to the changes that have occurred in the system during the past decade, the report issued by the California Commission on School Governance and Management in May 1985 has not resulted in any major improvements in the financial accountability of school districts.

Senate Bill 1379 (Alquist), Chapter 268, Statutes of 1984 contained a number of significant changes concerning K-12 financial accountability. One of the major changes it made was the transfer of the responsibility for developing the K-12 education audit guide from the Department of Finance to the State Controller. It also expanded compliance auditing of school districts by independent public accounting firms.

The Little Hoover Commission sponsored Assembly Bill 1366 (Hughes), Chapter 741, Statutes of 1985, which provided a reporting mechanism to ensure that local boards of education, the State Controller, and the Superintendent of Public Instruction would have at least the minimum financial and budgetary information that they need to more effectively oversee the financial viability of local educational agencies. While the Little Hoover Commission believed that this was a necessary first step to help bring greater accountability and control over school district expenditures, it recognized that the reporting requirements mandated by Assembly Bill 1366 did not address the overall problem of the configuration of the K-12 financial accountability structure, not did it provide the State Department of Education the sanctions necessary to put some teeth into its enforcement efforts.

More recently, Assembly Bill 2861 (O'Connell), Chapter 1150, Statutes of 1986, clarified provisions of Assembly Bill 1366 and provided $100,000 for the State Department of Education to facilitate the use of micro computers in school business applications. However, this effort also did not provide adequate enforcement or control powers at the State level over school district expenditures.

The State Department of Education has been developing and implementing the Financial Management Advisory Committee (FMAC) in the past two years. FMAC is establishing four major components to improve the financial management of school districts, including; a new program cost accounting and reporting system; a revised budgeting process; a new interim reporting system to assess the financial well-being of a school district; and, a restructured set of school district financial statements. Although FMAC will provide better information on school district financial operations, the FMAC effort is currently only operating in 46 school districts. The State Department of Education is planning to implement FMAC in additional school districts in the next few years. However, no firm plan has been adopted to implement FMAC statewide. In addition, while FMAC provides better information on school district finances, FMAC does not provide any enforcement powers at the State level.

The recent efforts at the State level have focused on providing needed financial and budgeting information on school district operations. However, these efforts have not provided the Superintendent of Public Instruction the authority, nor the responsibility, to oversee and enforce school districts' compliance with State financial requirements and ensure fiscally sound financial management practices. While the State has begun to shore up K-12 financial management systems, this information will be of limited value until there is a clear delineation of authority and responsibility in the financial management of the State's K-12 education system.

RECOMMENDATIONS

The Commission recommends that the State of California immediately initiate an effort to overhaul and improve the present financial accountability, reporting, and control system used in K-12 public education. Specifically,

1. The Legislature should more clearly define and expand the role and function of the Superintendent of Public Instruction to include a statutory obligation to closely monitor and be held accountable

the financial accounting, reporting, and use of funds by school districts.

2. The Legislature should adopt the single-audit concept in school districts throughout the State to eliminate unnecessary duplication of audit activities by different agencies, including the State Controller's Office, the State Department of Education, the Auditor General's Office, and public accounting firms.

3. The Auditor General's Office should be designated as the lead audit agency for conducting the single-audit of school districts and given the responsibility for conducting the financial and performance audits of all school districts in the State.

4. The Legislature should establish sanctions that the Superintendent of Public Instruction can use to effectively enforce prudent financial management in school districts. These sanctions should include:

    - Direct school districts to develop acceptable financial management plans;

    - Direct comprehensive management reviews of educational programs and an audit of the financial conditions of school districts when school district's fail to adopt sound financial management plans;

    - Direct school districts to develop or amend financial management plans based on the results of comprehensive management reviews or audits;

    - Monitor and enforce the implementation of financial management plans; and

    - Reduce or withhold any appropriation to a school district that does not comply with the implementation of sound financial management plans.

5. The Legislature should direct the Superintendent of Public Instruction to initiate a major statewide effort to reduce administrative costs in school districts. This effort should include:

    - Determining baseline administrative expenses at all school districts;

    - Reviewing the administrative spending policies, procedures and practices within school districts;

    - Establishing targets for each school district for reduction in administrative expenses; and

    - Monitoring and enforcing school districts' actions to meet targeted reductions in administrative expenses.

6. The Legislature should direct the Superintendent of Public Instruction to commit sufficient resources to the FMAC system to ensure that it is fully operational on a statewide basis by July 1, 1988.

7. The Legislature should direct the Superintendent of Public Instruction to conduct staff development training in school districts to ensure that school board members, administrators, and financial management personnel have adequate knowledge and training in the use and application of the FMAC system.

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The Commission maintains that it is imperative that the Governor, the Legislature, and the Superintendent of Public Instruction undertake the actions outlined in our recommendations to develop a financial management system in K-12 public education that reflects the economic realities of the State's current method of school finance. In addition, the Commission believes that the State of California will not have adequate assurance that the full benefit of its funding for K-12 public education is being realized until a more responsive system of financial management is put in place.

Respectfully submitted,

NATHAN SHAPELL, Chairman
James M. Bouskos, Vice Chairman
Senator Alfred E. Alquist
Mary Anne Chalker
Albert Gersten, Jr.
Haig G. Mardikian
Senator Milton Marks
Assemblywoman Gwen Moore
M. Lester Oshea
Abraham Speigel
Richard Terzian
Jean Kindy Walker
Assemblyman Phillip D. Wyman