EXECUTIVE SUMMARY

California's kindergarten through grade 12 (K-12) public school system is made up of 1,028 local school districts which operate more than 7,000 schools and serve approximately 4.3 million students.

In recent years, the source and amount of funding received by local school districts has undergone considerable change. Proposition 13 resulted in a shift of the primary responsibility for funding school districts from the local to the state level. Prior to Proposition 13, 53.9 percent of the total K-12 revenues came from local sources and 39.1 percent came from the State. Since the passage of Proposition 13, local revenues have decreased to 25.6 percent of total K-12 revenues and State funds have increased to 67.9 percent of all K-12 monies.

Due to the recent educational reforms in the K-12 public school system and associated funding increases, total K-12 revenues increased from $12.8 billion to $19.5 billion between fiscal year 1982-83 to fiscal year 1986-87, an increase of more than 50 percent.

In the past decade, the State of California has begun to initiate additional monitoring and control over the financial management of local school districts. The growing role of the State in the financial monitoring and control of local school districts is consistent with the fact that the majority of the funding for the K-12 public school system now comes from the State.

The Little Hoover Commission initiated its study of financial management and accountability in the State's K-12 public school system to determine the extent of current problems and to identify opportunities to improve and strengthen the use and control of funds in California's schools.

The Commission found that there is increasing evidence that a growing number of K-12 school districts are in poor financial health and have inadequate financial management. For example, 260 of the State's K-12 school districts and county offices of education, or 24 percent, engaged in deficit spending in their General Fund in fiscal year 1985-86. In addition, approximately 291 school districts in the State, or 26.8 percent, had General Fund balances of less than five percent at the end of fiscal year 1984-85. The poor financial management practices have resulted in some school districts seeking bail-out loans from the Legislature and may have contributed to the number of incidents of theft, fraud, and financial abuse in school districts. Moreover, it may result in an increasing number of districts seeking bail-out loans from the Legislature in the near future.

The Education Code requires that every school district have an independent financial and compliance audit each year. Since California's K-12 public school system is based on local control, the annual financial and compliance audits are the backbone of the State's oversight of district expenditures. The Commission's study revealed that the financial and compliance audit reports frequently do not meet minimum reporting standards established by the State Controller's Office. For example, the State Controller's Office rejected 173 financial audit reports, or 16.3 percent of all audit reports submitted by school districts in fiscal year 1985-86.

The study also showed that these audit reports are often submitted late, even though audit report submission deadlines are quite generous. For example, 457 districts, or 42 percent, submitted late audit reports for fiscal year 1985-86. Furthermore, the study indicated that the cost of performing financial and compliance audits of similar size districts varies as much as seven-fold.

The Commission's review showed that the State Department of Education has two major systems in place to collect management information used in assessing the financial condition and performance of school districts. However, the information provided by school districts to the Department is frequently inaccurate, incomplete or late. As a result, the usefulness of these systems as management tools at the state level is severely undermined.

The study revealed that the Superintendent of Public Instruction does not have sufficient authority to intervene in school districts that are not being fiscally responsible. For example, while the Superintendent has the authority to review and analyze financial reports and projections provided by school districts, the Superintendent does not have the authority to compel a school district to adopt or implement fiscally responsible corrective action plans. Although other states have provided their Superintendents the authority to intervene in school district financial affairs when the districts fail to be financially responsible, California has not done so. As a result, the State Superintendent of Public Instruction can only intervene in the financial activities of a school district after a school district has received a "bail-out" loan from the Legislature. By then, it may be too late.

The Commission's review indicated that there are a number of school districts which offer potential savings through consolidation. Specifically, the study identified 275 school districts that have enrollment of less than 300 students which potentially may be candidates for consolidation. In addition, the study showed that 114 school districts which spent less than the statutorily required percentage of expenditures on teachers' salaries in fiscal year 1985-86 also may offer some benefits through consolidation, such as cost savings or improved levels of service.

The Commission's report presents eight recommendations for improving the financial management and accountability in the State's K-12 public school system, including:

1. Provide the Superintendent of Public Instruction with greater authority to intervene in school districts that fail to act in a financially responsible manner;

2. Increase the number of financial management assistance reviews conducted by the State Department of Education in school districts;

3. Require that the annual audits of school districts contain additional information on a district's financial condition and performance;

4. Provide the Superintendent of Public Instruction with greater authority to impose sanctions on school districts that do not provide timely, accurate, or complete financial reports;

5. Increase sanctions against certified public accounting firms whose work fails to meet State standards;

6. Require that school districts establish broad-based audit selection committees;

7. Expand the fraud and abuse review component of school district audits; and

8. Conduct expanded training for independent auditors of school districts.