

## U-46 CAC Finance Committee – Deficit Frequently Asked Questions

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**A Note about Dates:** We tried not to use acronyms in this document, but for financial reporting dates to make sense we used FY to represent the district's Fiscal Year that starts on July 1<sup>st</sup> and ends June 30<sup>th</sup> the following calendar year. As an example, FY 2009 covered the period from July 1, 2008 to June 30, 2009.

### How did we get in this situation?

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#### What are the different parts of the deficit?

As of 6/30/2010 the district's total budget deficit is projected to be \$53.5 million. This deficit is the result of:

- \$19.7 million carryover deficit from previous to FY 2008 which came about largely from a change of accounting method (from cash to modified accrual)
- \$28.9 million in deficit from the FY 2009 year
- \$4.9 million projected deficit for the FY 2010 year, which was eliminated in the amended budget for FY 2010

#### What are "carryover deficits"? Did we just realize that they were there?

The budget of any school district is made up of many different "funds." These funds group together the revenues and/or expenses so all items related to a given category of financial items can be tracked together. In the normal course of operations, the balances of these funds increase and decrease during a given year. In most cases, at the end of any given year, the fund may end the year with either a:

- Surplus Balance – Not all of the revenue for the fund was spent since the fund was established.
- Deficit Balance – More money was spent than what was collected since the fund was established.

In the case of a surplus, the balance of money is carried forward into the next year. In the case of a deficit balance, money from the Working Cash Fund is "borrowed" so a fund is able to meet its obligations. In either situation, the fact a given fund is in surplus or deficit can change on a month-to-month and year-to-year basis.

For purposes of the current financial situation, FY 2010 year started with a total of \$(41.2M) deficits in the operating funds. These carryover deficits are roughly divided as follows:

Education Fund	\$(21.5M)
Operations and Maintenance Fund	\$(10.5M)
Transportation Fund	\$ (9.2M)
Total	<u>\$(41.2M)</u>

The amount a given fund is in surplus or deficit is reported in district financial reports and board budget presentations. From these reports and presentations, those individuals involved in the details of the district's financial processes are aware of any ongoing deficits.

#### Why wasn't the FY 2009 budget more accurate? Why did we miss it by \$28.9M? Why didn't we know about it sooner?

Budgeting is an estimation process based on what is known when the budget is prepared. What actually happens after the budget is approved can be different for a lot of reasons. The number of students enrolled in the district can change; enrollment at a given school can change and require additional staff. External factors impacting the budget can also change. Things like interest rates, health care trends, etc.

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make a big difference on the district revenue and expenses. The following presents the division of the deficit by Revenue Shortfalls and Expense Overruns.

<b><i>FY 2009 Budget – Revenue Shortfalls</i></b>		
Local Property Taxes	\$ (10.0M)	Prior year deterioration of Cook County collection rate to 97% (from 98%) and prior year adjustments from Kane County.
Federal Aid	\$ (3.9M)	Several federal aid payments were late. Although they were received, they were not received until after the end of FY 2009.
State Aid	\$ (3.1M)	Several state aid payments were late. Although they were received, they were not received until after the end of FY 2009.
Investment Interest	\$ (2.9M)	Deteriorating market interest rates and uncertainty about when state payments would arrive made it impossible to determine if short-term balances should be invested.
<b>Total Revenue Shortfalls</b>	<b>\$ (20.0M)</b>	(Total off because of rounding)

<b><i>FY 2009 Budget – Expense Overruns</i></b>		
Salaries	\$ (3.0M)	\$2.7M was in teacher's salaries. Some of this was because the district does not know the exact number of teachers that will be needed for a given year when the budgets are prepared.
Medical Insurance	\$ (4.0M)	Health insurance payments were higher than expected.
Retirement Contributions	\$ (3.0M)	Early retirement payments were \$1M higher than expected. The amount budgeted was based on the actual amount from the previous year. The overrun resulted because the cost per retiree was higher than the prior year as well as more people elected to retire in FY 2009 than were expected to. The remainder of the amount is a function of higher salary expense.
<b>Total Expense Overruns</b>	<b>\$ (10.0M)</b>	

### How is this situation different than the last “surprise deficit”?

The last “surprise deficit” occurred during the FY 2002 year. The deficit that suddenly came to light in 2002 was caused by district overspending and a lack of internal financial controls.

When the school district administration changed in FY 2002, a financial problem was discovered during an audit that year that resulted in a projected \$56 million deficit being reported. In response to this deficit, the district employed a Chief Financial Officer and tasked him with balancing the budget and implementing new internal financial controls. The district also delayed the opening of five newly built schools due to a lack of operating funds and instituted expenditure cuts totaling more than \$40M in FY 2003. These expenditure cuts impacted curriculum and increased class size.

The causes of the current district financial situation are very different from those of the previous situation. The primary cause of the sudden emergence of the current deficit was the general deterioration of the economy and tax revenues and more accurate reporting of the district's deficits resulting from the change of accounting methods.

We have not observed anything during the preparation of this document that would lead us to believe that any large portion of the current deficit is the result of large-scale waste, financial mismanagement, or lack of critical financial controls.

**How and why did an “accounting method change” cause part of the deficit?**

The difference between the cash and modified accrual accounting methods is all about the timing of how income and expenses are recorded in the district’s books.

**Cash basis** is very similar to how we maintain our personal checkbooks.

- Revenue is recorded when the cash is received.
- Expenses are recorded when the cash is paid.

**Modified accrual basis** is how most businesses keep track of their finances.

- Revenue is recorded when earned (regardless of when the cash is received).
- Expenses are recorded when incurred (regardless of when the cash is paid).

For example, using the modified accrual method, teachers' salaries are recorded as expenses when the teachers earn their salary (i.e., during the school year), not when their paychecks are issued. Teachers earn their salary during the regular school year, but they are typically paid throughout the summer, which is after the pay was earned. Teachers' salaries were a significant portion of the resulting \$19.7 million adjustment to change to the modified accrual basis of accounting. The following table details the adjustments made to the operating funds when converting from cash to modified accrual basis.

<i>Fund</i>	<i>Cash Basis Balance 7/1/09</i>	<i>Adjustment for Modified Accrual</i>	<i>Modified Accrual Basis Balance 7/1/09</i>
Education Fund	\$13,133,016	\$(20,012,546)	\$(6,879,530)
Operations and Maintenance Fund	\$(9,276,846)	\$545,460	\$(8,731,386)
Transportation Fund	\$(6,841,132)	\$2,770,785	\$(4,070,347)
<b>Total</b>	<b>\$(2,984,962)</b>	<b>\$(16,696,301)</b>	<b>\$(19,681,263)</b>

Details of the above amounts are presented in the Details of Cash to Modified Accrual Basis Change section of this FAQ.

One important thing to note is that no real money (i.e., cash) was created and/or destroyed by changing accounting methods. On June 30, 2009, the total cash and investments the district had on hand were \$57,615,563. On July 1, 2009, following the conversion to the modified accrual accounting method, the district cash and investment balance was \$57,615,563, exactly the same amount.

It is also important to realize that the amount of cash the district has on hand at the end of a given school year varies from year to year. The following list presents the ending cash and investment balances for the last six years.

<i>Cash and Investment Balances as of End of Fiscal Year</i>		
June 30, 2004	\$114,050,720	cash basis
June 30, 2005	\$97,970,932	cash basis
June 30, 2006	\$107,448,387	cash basis
June 30, 2007	\$116,770,102	cash basis
June 30, 2008	\$101,947,317	cash basis
June 30, 2009	\$57,615,563	cash basis
July 1, 2009	\$57,615,563	after conversion to accrual method

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One related thing to note from the above table is that, due to the state falling behind on its payments and the FY 2009 deficits, we had substantially less cash and investments on hand than normal at the end of the last school year. This is a big concern that the district is aware of and will be watching very closely.

District personnel did not suddenly decide to change the accounting method. District personnel have been looking into changing to modified accrual basis since approximately 2002, and the CAC Finance Committee has recommended the change for several years.

Conversion to the modified accrual basis is an important step to achieving financial transparency. Only by presenting the complete view of the district's financial picture (including unpaid bills and uncollected revenues) can we make intelligent judgments about the district's financial position.

### OK, but why did all this happen? Whose fault is it?

As with any complex problem, the district's current financial situation has many different causes. At a high level, the current deficits came about because of a combination of events. These events caused major revenues to fall short of projections and major expenses to exceed projections.

While the root cause of revenue being less than expected is the current economic situation, the expense overruns in FY 2009 have differing causes. Some of these causes (like the issue of not knowing the exact number of teachers needed in a given year) will happen every year, no matter what the district does. Other items that are difficult to predict price fluctuations for, like health insurance, will also exist every year. While these uncertainties are inherent to the budgeting process, it would be helpful if the district could find some way to account for and communicate the uncertainty of these items in the budget.

The CAC Finance Committee has not observed anything that would lead us to suspect that anyone at the district is guilty of any financial malfeasance. District financial personnel were, and are, very aware of the deficit issues and are dealing with the ramifications on a daily basis.

District leadership has repeatedly stated that total financial transparency is one of their primary tenets. In the course of studying the deficit in detail and developing this document, we have found that to definitely be true. The district has given us all detailed information that we asked for.

One criticism of the district that we can offer it is that they could have done (and should do in the future) a better job at more clearly communicating its financial status. The change to the modified accrual method will help give a more accurate view of district finances. The CAC Finance Committee is committed to working with the district to develop some kind of district financial status report that is easily understandable to everyone.

### Glossary of Terms

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**Asset** – Buildings, facilities, property and equipment owned by the school district

**Budget** – Estimate of the revenue to be received and the expenses that will be incurred over a specified period of time. The budget reflects the school district's current estimation of future financial conditions.

**Cash Basis** - Accounting method that records revenue and expenses only when money is actually received or paid out

**Deficit** – The amount that expenses exceed revenue

**Expense** – Costs incurred in the operation of the school district. Examples of expenses include payments to suppliers, employee wages, benefits, debt and depreciation.

**FY – Fiscal Year** is a 12-month period the school district uses for financial accounting. The school district's Fiscal Year that starts on July 1<sup>st</sup> and ends June 30<sup>th</sup> the following calendar year. As an example, FY 2009 covered the period from July 1, 2008 to June 30, 2009.

**Fund** – A separate accounting entity used to track revenues and expenditures dedicated to a specific purpose. For example, the transportation fund is money dedicated to the operation of the school district's bus system.

**Liability** – An obligation that legally binds the school district to pay a debt or expense.

**Modified Accrual Basis** – Accounting method that records revenue when earned and expenses when incurred

**Payable** – Accounts payable are short-term debts that must be paid off within a given period of time.

**Revenue** – Money received by the school district. Revenue sources include tax dollars, fees, fines, inter-governmental grants or transfers, as well as any sales that are made.

**TRS – Teacher Retirement System** is the public pension plan for Illinois public school teachers and administrators. It was created in 1939 for the purpose of providing retirement, disability insurance and survivor benefits to all full-time, part-time, and substitute Illinois public school personnel employed outside the city of Chicago in positions requiring certification by the Illinois State Board of Education.

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### Details of Cash to Modified Accrual Basis Change

The following tables present the details of the adjustments that were made when the district converted from the cash basis to the modified accrual basis accounting. Please note that most of the items in these lists are identified as pertaining to FY 2008. Adjustments were required for these items because, while the financial activity occurred prior to June 30<sup>th</sup> 2008, the actual exchange of cash did not occur until FY 2009 (which started July 1<sup>st</sup> 2008).

<b>Education Fund Cash to Accrual Basis Adjustments</b>		
FY 2008 Corporate Personal Property Replacement Tax Receivable	\$649,133	Money collected by the state as Corporate Personal Property Replacement Tax for FY 2008 that had not yet been paid to the district
FY 2008 Grants Receivable	\$7,909,174	Grant money due from the state and federal governments for FY 2008 that had not yet been paid to the district
FY 2008 Property Taxes Receivable	\$6,882,204	Property taxes collected by the counties for FY 2008 that were not yet paid to the district
FY 2008 Salaries Payable	\$(23,461,947)	Salaries earned in FY 2008 but not paid until FY 2009. These salaries are for the last pay period in FY 2008 for hourly employees and were paid in July 2008. A portion of this amount is for teachers who earn their salary over the school year but are paid out the remainder of their contract over the summer.
FY 2008 Health Insurance Liability Payable	\$(5,732,920)	Insurance costs incurred during the last month of FY 2008 but not paid until FY 2009. The district also believes this amount was high due to the number of employees laid off in the Spring who utilized their health benefits while still covered by the plan.
FY 2008 Accounts Payable	\$(3,045,993)	Various bills that were for expenses incurred in FY 2008 but not paid until FY 2009. These expenses include items like instructional materials, professional services, and utilities.
FY 2008 Teachers' Retirement System Liability Payable	\$(3,003,571)	Retirement plan contribution for the final period of FY 2008; not yet paid to the TRS
Additional Auditor Adjustments	\$(208,627)	Other miscellaneous accounting reclassifications
<b>Total Education Fund Adjustments</b>	<b>\$(20,012,546)</b>	

<b>Operations and Maintenance Fund Cash to Accrual Basis Adjustments</b>		
FY 2008 Property Taxes Receivable	\$744,023	Property taxes collected by the counties for FY 2008 that were not yet paid to the district
FY 2008 Accounts Payable	\$(232,680)	Various bills that were for expenses incurred in FY 2008 but not paid until FY 2009
Additional Auditor Adjustments	\$34,117	Other miscellaneous accounting reclassifications
<b>Total Operations and Maintenance Fund Adjustments</b>	<b>\$545,460</b>	

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<b><i>Transportation Fund Cash to Accrual Basis Adjustments</i></b>		
FY 2008 Grants Receivable	\$2,626,350	Grant money due from the state and federal governments for FY 2008 that had not yet been paid to the district
FY 2008 Property Taxes Receivable	\$220,268	Property taxes collected by the counties for FY 2008 that were not yet paid to the district
FY 2008 Accounts Payable	\$(86,241)	Various bills that were for expenses incurred in FY 2008 but not paid until FY 2009
Additional Auditor Adjustments	\$10,408	Other miscellaneous accounting reclassifications
<b>Total Transportation Fund Adjustments</b>	<b>\$2,770,785</b>	