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REACTION TO BUDGETARY STRESS IN MICHIGAN
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**REACTION TO BUDGETARY STRESS
IN MICHIGAN PUBLIC SCHOOLS**

By

Maria A. Bolen

A DISSERTATION

**Submitted to
Michigan State University
In partial fulfillment of the requirements
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ABSTRACT

REACTION TO BUDGETARY STRESS IN MICHIGAN PUBLIC SCHOOLS

By

Maria A. Bolen

This study focuses on how school districts in Michigan are reacting to budgetary stress brought on by the downturn in the economic climate. It addresses the key factors school districts can implement to increase revenues or decrease expenditures and identifies which of these factors districts choose and the reasons why. This study also analyzes the effectiveness of the various measures implemented in restoring or maintaining the financial health of the district. The research seeks to generate useful lessons about strategies for improving district financial conditions.

The research also pays particularly close attention to districts that are either in deficit or are close to a deficit status. A number of these districts have been successful in making budgetary adjustments that have permitted them to strengthen their financial condition and avoid falling into a deficit. Accordingly, a comparison will be made of the finances of Deficit Districts, Near-Deficit Districts, and all other districts in the state.

To determine more about the financial status of school districts in the State of Michigan, two main questions are posed. First, how have levels of fiscal stress – measured by district fund equity – changed over the past five years for all districts in the State of Michigan? Second, what factors have contributed to strong or weak fiscal positions of Michigan's school districts?

The empirical work will be based on an analysis of the finances of all the districts in the State of Michigan, plus a detailed study of the budgets and decision-making in a sample of six districts. The six districts are located in a highly populated suburban area located in a major metropolitan center (Detroit), with a great degree of racial, ethnic and socio-economic diversity.

Findings show that in the research setting studied, there is not a “one-size-fits-all” pattern of revenue enhancement or expenditure reductions present in the behavior of school districts. School districts had to consider a variety of internal and external influences before decisions to implement certain measures were made. Thus, what measures can be implemented to improve the financial health in one district, may not be feasible to be implemented in another district. Furthermore, certain revenue enhancement and expenditure reduction measures appear to have a negative affect on fiscal health.

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CHAPTER I

INTRODUCTION OF THE RESEARCH TOPIC

The environment that school districts in the State of Michigan are currently operating in would dictate that all schools feel pressure to generate new revenue through student enrollment and reduce expenditures with budget reductions. Since 2002, annual increases in per pupil foundation grants have not kept pace with the rising costs of education. Furthermore, with the Passage of Proposal A in 1994, voters shifted Michigan from a relatively decentralized school finance system to a highly centralized one under which state aid is allocated on a per-pupil basis. The new funding structure focused school districts' attention on recruiting and retaining students in a competitive environment because more students translate to more revenue. Effective management of school resources is essential now that public schools are competing for students not only with parochial and private schools but also with charter schools and other public school districts through Michigan's inter-district choice program known as Schools of Choice. To maintain their competitive edge, public schools are reluctant to slash non-instructional services, such as transportation, athletic offerings and student services.

To further compound the problem, Michigan is currently experiencing a downturn in the economic climate with many families leaving the State for employment opportunities elsewhere. Because of this out migration, local districts are competing over a diminishing pool of students in an effort to secure additional operating revenues. Many school districts are facing budgetary shortfalls, and are looking for creative ways to cut

costs and improve efficiency. Because of the pressure to attract and retain students by maintaining quality programming with less funding coming from the State, it is important for research to identify available options for school districts and to assess the effectiveness of current district operations.

A statewide review of the financial condition of school districts does not shed light on individual district behaviors. This research seeks to discover if there are consistencies in behaviors as it relates to the financial condition of particular districts and why those behaviors exist. Of particular interest are the two following issues:

- If patterns exist in the adoption of particular practices and the level of fund equity.
- What factors, internal or external, influenced districts to implement or reject certain cost cutting or revenue enhancing measures.

How school systems react to fiscal stress will, for the most part, determine whether the school district will experience fiscal health or continue to struggle financially. A wide-range of measures has been proposed for school districts to reduce their costs and increase their efficiency. This dissertation examines the extent to which financially strapped districts have adopted these various cost cutting strategies. The research seeks to generate useful lessons about strategies for improving district financial conditions. The research also pays particularly close attention to districts that are either in deficit or are close to deficit status. A number of these districts have been successful in making budgetary adjustments that have permitted them to strengthen their financial condition and avoid falling into a deficit. Accordingly, a comparison will be made of the finances of Deficit Districts, Near-Deficit Districts, and all other districts in the state.

The Key Questions to Be Answered

In the research setting to be studied, the research addresses two basic questions. The first question, how have levels of fiscal stress—as measured by district fund equity—changed over the past five years for all districts in the State of Michigan?” Due to the current economic climate, it would be reasonable to assume that the level of fund equity has declined as a result of ongoing poor fiscal conditions. But school districts may have been able to respond to this decline in economic conditions by taking the appropriate measures in order to survive. Thus, the first task of the study is to determine whether schools are responding effectively to the downturn in the economic climate and preserving fund equity by expenditure reductions and revenue enhancements.

The second question, what factors have contributed to a strong or weak fiscal position of Michigan’s school districts? If indeed school districts were able to respond with the appropriate measures of revenue reductions and expenditure enhancements, what were those measures? There are many ways districts have sought to generate additional revenue or cut costs. The purpose of this study is to determine the reaction of local school districts in Michigan to the state’s lengthy school funding crisis. This research will document to what extent financially strapped districts have implemented various cost cutting measures and analyze their effectiveness in restoring financial health to the district.

Qualitative and Quantitative Study to Measure Fiscal Stress

To answer the two key questions noted, a survey of school districts will be conducted. The research setting will be school systems in Oakland County, Michigan, where budget reductions and revenue enhancements measure have been implemented in response to the economic crisis. Furthermore, interviews of six school districts, chosen by the varying level of fiscal health, will be conducted in an effort to delve more deeply into the particular reactions of school districts during the difficult economic climate.

Significance of the Study

While the results of the study will not be able to be generalized or quantified to a very specific set of policy rules that can be recommended for adoption by all school districts in the State of Michigan, the results will provide insightful and useful information about the specific ways certain school districts responded to budget reductions and revenue enhancement initiatives, and at least in these instances identify the factors that influenced the behaviors of the districts studied. Not only can this study provide useful data for identifying key behaviors that exist in school districts of varying financial condition, but it can also provide feedback for very specific behaviors that have been implemented in financially healthy school districts. Thus, the information can be useful to educational decision makers throughout Michigan.

CHAPTER II

REVIEW OF LITERATURE

Faced with increasing financial challenges, school districts have struggled to balance their budgets while continuing to maintain or enhance programming and instructional quality. The pressure is even more intense now because for the first time in our nation's history, schools are required to produce measurable evidence that all students are learning, and they are being asked to do so amidst fiscal crises at the state and local levels. Current research provides limited information about how schools react to financial challenges. To fully understand why districts are faced with a financial crisis, we must better understand how schools are funded and how schools use the resources currently available to them. Fiscal stress is not just a component of how districts spend their money. Factoring in the revenue structure is also an important component in determining where the problem lies. Understanding the funding and resource allocation of schools is the first step in identifying the factors that contribute to an environment of fiscal stress.

School Funding in Michigan

In 1994, the voters in the State of Michigan approved Proposal A, which dramatically changed the system for funding K-12 public schools. Prior to Proposal A, local property taxes were the main source of revenue for school districts. Reliance on local property taxes produced wide and growing inequities among Michigan school

districts. Local voters approved millages for current operating and capital expenditures, making funding education up to local discretion. Despite the allocation of state equalizing aid through a district power equalizing formula, variations in funding levels across districts before Proposal A were strongly linked to local property wealth. Districts with extensive property wealth per pupil could generate large amounts of school revenue with low millage rates. These districts were able to provide lavish support for local schools while keeping property tax rates low. In contrast, property-poor school districts were obliged to tax themselves at higher rates to raise smaller amounts of revenue (Arsen & Plank, 2003). Opponents of utilizing property taxes as the major source of revenue for school districts point to this fact as the major reason for disparate funding from one school district to the next.

Proposal A increased the state sales tax from 4% to 6%, while dramatically lowering local school property tax millages. Revenue from the additional 2% sales tax went to fund school districts, which increased equity across school districts. This sales tax increase became a major funding source for school districts, and reduced the reliance for school funding on property taxes. School funding was now determined by the State Legislature and the Governor, and local voters no longer had any discretion to set millages for operating expenditures in their local schools. School funding levels were also now more sensitive to fluctuations in the State's economy by way of sales taxes.

Through the relatively prosperous 1990s the new funding structure worked well, as statewide real per pupil revenues increased while gaps in funding levels between high-revenue and low-revenue districts were narrowed. However, since 2001, Michigan's economy has experienced a protracted downturn with no turnaround yet in sight. The

depressed economy has diminished school funding and strained many school districts. In some years the state budget was so bleak that schools had to accept mid-year reductions in their school aid. Calls for changes in Proposal A have become more common.

Evidence on School Funding

Local Sources – Property Taxes

Local school districts have traditionally financed the majority of their educational revenues through local property taxes (Odden & Picus, 2004). This is because property is fixed in a location and values tend to change slowly which gives school districts a stable source of revenue. However, the large variation across districts in their capacity to raise revenue relative to the educational challenges they face requires some districts to impose much heavier tax burdens on their residents than other districts to provide a given quality of education services. Although some of the apparent resulting inequities may be offset in part by compensating differences in state aid to school districts or in local housing prices, undoubtedly some inequities remain. The other aspect is the heavy reliance of education funding on the local property tax, which many people believe imposes a regressive burden on taxpayers (National Research Council, 1999).

State policies designed to lessen the disparities among school districts in terms of property tax revenues generated are referred to as equalization policies. Traditional funding equalization mechanisms—such as district power equalization and foundation programs—ensure a basic level of educational funding through a combination of local and state sources. In low-wealth districts, the state provides additional funding, while

high property wealth districts are able to increase discretionary funding from local property taxes. Despite the long-term growth of state equalizing aid, property taxes still remain the largest single source of revenue for school districts in many states mainly due to the continued desire to maintain local control of school funding. Why does education garner such financial support from taxpayers? Local voters typically view such spending as generating net benefits in the form of enhanced educational and economic opportunities for local children and improved market values of local real estate. (Hummel-Rossi & Ashdown, 2002).

State Sources – Funding Formulas

While property taxes have traditionally produced the largest share of revenues for U.S. public schools, the state's role has progressively increased since the 1930's. For the nation as a whole, state revenues surpassed local revenues by the late 1970s, although the balance between state and local revenues varies greatly from state to state (Odden & Picus, 2004). The state revenue is delivered to the school districts in the form of state aid, which is typically unrestricted and can be used for the general operations of school districts. The way states provide aid to school districts vary from state to state, but most follow a school finance formula that allocates school revenue on a per-pupil basis based on enrollment. Michigan happens to be a state that generates the majority of school funding revenue from a foundation allowance based on enrollment. This funding based on enrollment translates to a numbers game when it comes to educating students. Students are tied to dollars and when enrollment increases, so does funding levels.

Federal Sources – Categoricals and Grants

As previously mentioned, the majority of funding for Michigan's schools comes from state aid in the form of a per-pupil foundation allowance, which ensures that the typical student's education is funded at the same level in most districts across the state. It is also apparent, however, that not all students are typical. Some students' needs are greater than others and these students are more costly to educate. The foundation allowance can be inadequate to meet the needs of these special groups. State aid formulas typically make adjustments for environmental factors, most often in the form of a categorical provision in the school aid act. The revenue source for this additional funding is often federal dollars that flow to states based on specific criteria and then are passed on to individual districts based on their student needs. These categoricals provide supplementary instructional and pupil support services for students who meet certain criteria specified in legislation. Many student characteristics are targeted for additional resources: students diagnosed with a particular physical or emotional disability, students with identified reading deficiencies in the early education years, students from low-income families who required funding for their breakfast and lunches, students placed in public schools by the court system, students who are English language learners, and students with discipline problems.

If these high-cost student's characteristics were evenly distributed across all school districts in the state, there would not be a need for special categorical adjustments to the state aid formula. This additional funding could simply be included in the basic per-pupil state aid formula. Unfortunately, these special needs students are not evenly

distributed across local districts. Students from low-socio economic backgrounds and English language learners are typically clustered in urban districts and isolated rural districts. Some suburban districts develop extremely effective programs to serve children with specific disabilities, which in turn induces families of children with such disabilities to move to those particular districts (Odden & Picus, 2004).

Other federal categorical grants are earmarked for particular federal initiatives or to address specific student needs. The money is designated to carry out the particular initiative that the grant was written for and cannot be used as discretionary money for schools to achieve their regular education goals. Though they supplement schools' regular revenues, such funds only support supplemental services for special-need students and often require receiving districts to provide additional services from their own revenues that would not be provided in the absence of the federal grants

Evidence on School Resource Allocation

Understanding how the education dollar is allocated and used is the first step in identifying the costs of various services provided by the K-12 public schools in the U.S. The National Center for Education Statistics (NCES) inaugurated a project to collect detailed and consistent data on school expenditure allocation for cross-state comparisons (Picus, 2000). Research on school resource allocation has traditionally focused on school districts as the level of analysis, since the data are reported to states and the NCES from local districts. All 50 states collect some kind of fiscal data from their school districts. These data include information on district revenues and expenditures, as well as numbers

and characteristics of district employees. The revenue data generally identify the sources (federal, state, or local) and amounts of revenue received by each school district.

Expenditure data are most frequently collected by object of expenditure, such as professional salaries, classified salaries, employee benefits, materials and supplies, and capital expenditures. States now also collect and report expenditure data by broad functional areas – instruction, instructional support, student support, administration, transportation, plant operation and maintenance, and debt service – and several also report by program area – such as regular education, compensatory education, special education, and bilingual education (Odden & Picus, 2004). Districts also have the capability of allocating resources at the school level.

School-level resource allocation data is less detailed and complete. In most urban districts, current budgeting and accounting practices provide no means to compare resources across schools with different student populations. Because student population isn't reported in budgets, district budgeting processes create large differences in school budgets that are often hidden. For example, one building could appear to have an unequal amount of funding compared to another, but the reason for this could be the larger student population in one building that the other building doesn't have. Despite the large sums of money spent annually for K-12 education we know remarkably little about how those funds are used at the individual student and school level. The focus of most state finance reporting systems is on fiscal accountability, not understanding how or why resource decisions are made. These systems generally focus on object level reporting. As a result, we know a great deal about how much our schools spend for salaries, benefits, and contracts or broad function categories (e.g., instruction,

administration, pupil services, maintenance and operations, transportation), but we know relatively little about how much is spent on individual programs (Picus, 2000). Current researchers are beginning to conduct studies to clarify school-level resource allocations.

So where does the money spent on education go? The majority of school district expenditures are dedicated to salaries and benefits of the district's professional teaching staff. Many in education claim that because most of the education dollar is spent on salaries and benefits, schools are less able to engage in using resources differently. A review of expenditure levels over time reveal that the amount spent directly on instruction has remained about the same since the 1950's although allocation of real dollars per pupil has risen and the major portion (61 percent) of the education budget is spent on instruction (Odden & Picus, 2004).

In the middle of the century, most instructional expenditures were for classroom teachers – that is, licensed teachers who taught a classroom of students the regular curriculum for most of the day – the typical elementary school teacher at the primary level and subject-matter teachers in mathematics, science, social studies, and English at the secondary level. As a result, the staffing in most elementary schools included a principal and one teacher for every 25 to 30 students – a fairly simple staffing structure.

By the close of the century, the portion of classroom teachers as a percentage of the instructional budget declined significantly. At the same time, the portion of specialist teachers providing instruction in subjects such as art, music, and physical education and/or instructing students with special needs, largely in resource rooms separate from the regular classroom, increased (Odden & Picus, 2004). Various staffing models and staffing patterns are utilized to determine what the optimal staffing level should be.

Unfortunately, many districts run out of financial resources before achieving this optimal level. With ongoing budget constraints, staff reductions are about the only place districts can turn to achieve the kind of cost savings necessary to balance their budgets.

In an effort to determine the cost of a particular educational program or intervention, Levin & McEwen (2001) developed the ingredients method of determining the cost of education services. The ingredients method attempts to identify the cost of the component human and material inputs necessary for the production of a given program or instructional service. If the ingredients necessary to provide a program or service can be identified and valued, then the cost of the program or service can be estimated. To apply the ingredients method, one must first know what the ingredients used in the intervention are. School districts typically break their expenses down into the follow categories: personnel, facilities, equipment and materials, other inputs and required client inputs. The most common method of placing monetary value on each of these ingredients is using their market prices. This type of costing out is beneficial because there are reasonable competitive markets for many of the ingredients used in an intervention and these prices are readily available and are a simple way to derive cost data. The ingredients method offers decision makers better information regarding a given program's true cost than the standard budgetary items derived from a district's accounting records.

Rothstein (1997) examined the share of increased educational spending from 1991 to 1996 devoted to services for students with disabilities, school lunch and breakfast program and bilingual education. Given slow growth in school revenues, state and federal requirements for district services for special needs students could squeeze funding

available for regular education programs, Rothstein found. Boyd, Lankford and Wyckoff (2002) studying budgeting patterns of New York school districts between 1980 and 2000 found that a substantial share of increased spending was devoted to students with disabilities and inflation in the costs of purchased inputs. They also found that when enrollments fall sharply, per-pupil spending patterns do not change. The same pattern was found when enrollments rise sharply, districts tend not to raise spending sharply. Furthermore, districts in New York appear to employ discretion in their budgeting practices to smooth expenditures over time and to alter the mix of expenditures depending on fiscal circumstances.

The Efficiency Debate

The additional resources provided to schools over the past few decades have not translated to increased student achievement. The lack of proportionate improvement in student outcomes with rising expenditures raises questions about the efficiency of public schools. As one examines the field of education, few studies are found in which cost-benefit and/or cost-effectiveness analyses are undertaken in relation to program decision-making (Hummel-Rossi & Ashdown, 2002). Progress has been slow in the adoption of either cost-effectiveness analyses or cost-benefit analyses in educational evaluations. However, the New York Adequacy Study (Hanushek, 2005) and the Highscope Perry Preschool Program (Barnett, 1996) are detailed examples about the efficient use of educational resources to improve student outcomes. Schools today are short sighted and focused on balancing their budget and typically look at the cost side of programs that are

earmarked as potential eliminations to balance their budgets. Little thought is given to the long-term effectiveness of the program or additional future costs that may arise due to a program's elimination. There is wide agreement that greater application of cost-benefit analyses in education is warranted.

Cost of Special Needs Students

A larger share of school budgets are being spent outside of the general education curriculum on students with special needs, causing much debate in the educational arena. These additional expenditures are another cause of fiscal stress. In examining expenditure patterns, there is a reduction in the share of spending attributable to regular teaching contrasted to the substantial increase in the share for teaching students with disabilities. Given the implementation of Public Law 94-142, the Individuals with Disabilities Education Act, mandating free and appropriate education of all students with disabilities in the least restrictive environment during the 1980s, it is not surprising that special education expenditures grew dramatically during this period. At the same time, changes in accountability systems and raised standards for all students have a disproportionate impact on students with disabilities since they have farther to go and greater difficulty getting there than non-disabled students. Addressing these new requirements is generally more expensive for students who require smaller class sizes and more intensive services. However, it is remarkable that this growth commanded such a large portion of all additional real expenditure per pupil. Much of this growth is attributable to a substantial increase in the classification of special education students, especially among the learning disabled category (Boyd, Lankford & Wyckoff, 2002).

The demographics of students with different types of special education needs vary from school district to school district. Some districts have a higher concentration of such students than others. Some of the largest metropolitan school districts have extraordinarily high percentages of students who need supplemental educational services. Furthermore, the prices districts face in providing these additional services vary considerably, further intensifying the fiscal burden of appropriately educating students with special needs. Large central cities face the highest prices and usually have the highest concentration of special-needs students. Many rural districts, which generally have lower prices, tend to face high costs for special-needs students because the low incidence dramatically increases the per-pupil costs of the necessary services (Odden & Picus, 2004).

Factors Predicting Fiscal Stress

While there is no single definition of fiscal stress, researchers and practitioners often distinguish between short-term fiscal difficulty, cyclical fiscal difficulty, and longer-term or structural forms of fiscal difficulty. Katherine Bradbury (1982), for example, distinguished between “budgetary fiscal distress” – difficulty in balancing the budget – and “citizen fiscal distress” - when a citizen can’t obtain a reasonable level of services at a reasonable sacrifice.

Budgetary stress often is the result of cyclical forces, such as recessions, which can generate relatively brief but sharp deterioration in a government’s fiscal condition. Recessions can affect the finances of school district directly through declines in

economically sensitive local revenue sources like sales taxes, and indirectly through declines in intergovernmental revenue, particularly declines in aid from the state, which in turn relies heavily on revenue sources highly sensitive to cyclical economic changes (Boyd, Lankford, & Wyckoff, 2002).

Fiscal stress can also be exacerbated by poor financial management practices. School districts that do not employ prudent financial practices are more likely to suffer ill effects during either short-term cyclical economic downturns or longer-term deterioration of the economic base. Typically, both short and long-term stress is beyond the direct control of most school districts. However, how school districts anticipate and react to economically stressful periods is not. Fiscal stress is of interest for a variety of reasons; ultimately we are interested in stress to determine what affect it has on the education of students (Boyd, Lankford, & Wyckoff, 2002).

Although substantial research supports the need to analyze fiscal stress for corporations, cities, and school districts, many questions remain regarding how best to predict fiscal stress. Although many school districts are facing fiscal problems now or will in the near future, we know relatively little about the causes of the problems or how to avoid them. If school districts could identify the factors that contribute to fiscal stress, they would be in a better position to monitor their status annually and alter their financial behavior to prevent future problems (DeLuca, 2006).

While many researchers have attempted to identify ways to predict fiscal stress for corporations and municipalities, few have investigated fiscal problems in school districts. Murphy (1980), Lee (1983), and Smith (1985) investigated fiscally troubled school districts in Ohio. Murphy found that rural districts were most likely to be

financially troubled, as were districts with lower median incomes and districts with higher interest payments, lower revenue per pupil, higher plant maintenance expenditures, higher health expenditures or fewer requests for millage increases. Lee found liquidity to be a major predictor of fiscal stress, with investment earnings and salaries, wages, and fringe benefits contributing much to predictive power. Borrowing ratios, staffing ratios, and operating expenditure ratios had little or no predictive power. Smith attempted to predict fiscal health for three years for all school districts in Ohio. The category of salaries, wages, and benefits was the most important for the predictions. In a qualitative study, Manca, Noonan, and Matranga (1999) found that 14 factors common to three districts studied contributed to insolvency. These common factors included overspending of general revenue funds, the need for a state loan, and inadequate staffing in the business office.

Duncombe and Yinger (1998) presented a conceptual framework depicting different dimensions of school district financial condition and applied it to New York School districts. Their framework included four components: short-run financial condition, long-run financial condition, economic condition and student performance. The outcome of the study was that no single indicator or set of indicators was likely to accurately predict school districts at risk of future financial crisis. Therefore the study incorporated 50 different measures to provide a comprehensive view of financial conditions in New York school districts.

Boyd, Lankford, and Wyckoff (2002) examined changes in real per-pupil spending for districts with different levels of fund balances at the start of the period of fiscal stress. The study found that when districts have healthy cushions in the form of

large fund balances, they weathered difficulty without making sharp cuts in teaching expenditures, while districts with low fund balances reduced expenditures sharply. The results of the study had major implications that were relevant to policy makers. Namely, what the appropriate balance in funding across a variety of expenditure categories should be, but especially between special education and regular instruction. Furthermore, districts should be particularly mindful of the difficult fiscal position they currently face and are likely to confront for a few years. This study also mentions that rising health care costs and increased needs for contributions to retirement funds further exacerbated budgetary stress. The authors recommended that districts adopt conservative budgeting practices with prudent fund balances to help smooth out short-term economic cycles.

Measures Implemented by Fiscally Responsible School Districts

Even in the absence of compelling evidence, there are many conceptions of what constitutes efficient school district use of resources. In recent years the Mackinac Center for Public Policy, the Michigan branch of a national network of conservative policy advocacy groups, has embarked on a visible campaign to promote practices that it argues will enhance school efficiency and fiscal health. *The Six Habits of Fiscally Responsible Public School Districts* (Mackinac Center, 2002) summarizes these prescriptions.

First, districts should minimize administrative costs by outsourcing district-run functions, such as payroll, benefits administration and records management or by eliminating certain administrative positions all together. The Mackinac Center argues that by trimming administrative costs, classroom expenditures can be more readily

maintained. Second, districts should cut costs through outsourcing the provision of all non-instructional services (e.g., custodial, maintenance, transportation and food service) to private companies. Private contracting enables districts to reduce payroll taxes and retirement costs because schools are required to fund the retirement costs of all employees on their payroll. This cost is currently around 17% of school districts' gross payroll in Michigan. Eliminating the required retirement contribution by shifting to contracted employees represents a substantial potential cost savings for school districts. Third, Mackinac advocates negotiating increased health insurance co-payments and deductibles with employee unions in order to lower districts' premiums. Fourth, districts should pass sinking fund millages to generate revenue for facility maintenance and renovations and thereby take this financial burden off the general fund. Fifth, districts should participate in the Schools of Choice program to generate additional revenue from increased enrollment. Sixth, the Mackinac Center suggests that districts reform collective bargaining so they may be free to negotiate individually with teachers instead of negotiating collective bargaining agreements with employee unions. Many of the recommendations of the Mackinac Center for Public Policy are being evaluated through the research questions posed in this dissertation. The relevance of many of these factors will be examined in the empirical work and the results will be reported.

Conclusion

In this new era of accountability based on performance, public education must address the fundamental challenge of improving learning for all students. School finance

cannot stand apart from this challenge because of the limited resources typically available to schools and also because of the link between funding and student achievement. It is important that educational decisions be aligned with resources to increase improvement and ensure equitable and adequate opportunities for all children to reach these elevated standards. No longer satisfied with providing bare-boned schooling to prepare individuals for an industrial society, many educators find it imperative to educate all students to become competitors in a knowledge and global based society. Such high standards demand more than a bare-bones financial system. Identifying the areas of educational spending that are costly and inefficient is essential in this era of limited financial resources for school districts.

Identifying key factors that contribute to fiscal stress of school districts is essential to help schools alter their course of financial insolvency. Equipping school boards and school administration with the knowledge of what these factors are helps better decisions to be made regarding allocating limited resources instead of leaving decisions makers to rely on guesswork or politics to make their decisions. Discovering what other districts with similar funding and expenditure components are doing to maintain fiscal health is essential information to alter expenditure patterns to promote fiscal solvency. Based on this research, it would be expected that certain thresholds for benchmarking could be developed so each school district can readily predict the likelihood of fiscal stress before it occurs and thus address ways to reduce or eliminate the chance of becoming bankrupt. In Michigan, where state funding is tied to sales tax revenue, which is further tied to the health of the economy, tax and expenditure limitation movements, declining enrollments, and recessions all have negative impacts on

educational budgets, and it is important to take into account costs as well as other aspects of the alternatives. Schools are continually called upon to do more and more with less and less, which makes the value of every dollar spent more valuable.

The current research proves that studies have been done to understand how the education dollar is allocated. The National Center for Education Statistics has collected detailed and consistent data on school expenditure allocations for comparisons. Once an understanding was gained on how districts allocated their resources, current research further identified how resources were tied to outcomes. The additional resources provided to schools over the past few decades have not translated to increased student achievement. This lack of increased achievement raises questions about the efficiency of public schools. Further research has been conducted regarding the rising costs of students with special needs and how these additional expenditures have further strained district's budgets. Other factors besides additional special needs expenditures have been identified to predict fiscal stress, however many questions still remain. Factors that fiscally responsible districts engage in have also been identified in current research, however a link has not been made between the varying degrees of fiscal stress a district may be experiencing and how these districts respond to fiscal stress.

The focus of my research is to determine how districts in the State of Michigan are responding to many years of inadequate funding levels, how resource allocations have changed as a result of the financial climate, what internal or external factors determine where the limited resources are delegated, and what factors contribute to fiscal stress for a school district. Lastly, I am interested in determining the reaction of local school districts in Michigan to the state's lengthy funding crisis. This will be accomplished by

identifying the factors that contribute to why some school districts faced with the same resource allocations are able to maintain fiscal health, while other school districts with the similar resource allocations are in fiscal stress. The hope is that this research will bridge the gap between where current research left off - at factors predicting fiscal stress and measures implemented by fiscally responsible districts, to answer the question of how districts in the State of Michigan respond to varying degrees of fiscal stress.

CHAPTER III

RESEARCH DESIGN AND METHODOLOGY

Purpose of the Study

The purpose of this study is to determine the reaction of local school districts in Michigan to the state's lengthy school funding crisis. Since 2002, annual increases in per pupil foundation grants have not kept pace with rising costs. Consequently, virtually every district in the state has been forced to respond to declining real per pupil revenue over the last five years. How school systems react to fiscal stress will, for the most part, determine whether the school district will experience fiscal health or continue to struggle financially. For this study, fiscal stress is defined as low fund equity as a percentage of general fund revenues. Fund equity is the difference between the district assets minus district liabilities. In other words, fund equity is the net worth of the district. Fund equity is an appropriate measure of fiscal condition because it compares the annual revenue that is generated each year with the net worth of the district. Furthermore, under current Michigan Department of Education procedures, a district with either a deficit fund balance in the General Fund or a deficit in any other funds that surpass the surplus in the General Fund is considered a "Deficit District" for purposes of this study. "Near Deficit Districts" are those districts with a low percentage of fund equity.

Michigan is a prime laboratory for exploring the questions posed because this state does not rely on local property taxes to fund school district current operations. Therefore school funding is centralized at the state level, eliminating the ability for local

schools to generate more millage in a time of budgetary constraints, and creating a somewhat uniform per-pupil funding structure. Furthermore, the Schools of Choice program in Michigan has created an environment of competition within school districts to attract and retain students by enhancing educational opportunities, which could be a contributing factor on budget reduction decision making if districts are either losing or gaining students. Growing districts may choose to not make any budget reductions but rather balance the budget with increased enrollment, while declining enrollment districts may have to make severe budget reductions to accommodate the loss in per-pupil revenue. School districts are not required to participate in the state choice program. Schools can opt in or out of the program. Thus, we will want to find out if schools are participating and what factors influenced their decision.

The first basic question to be explored is “how has fund equity as a percentage of general fund revenue changed over the past five years for all districts in the State of Michigan?”

Because districts have been experiencing several years of moderate to no increase in state aid, and in some years actually experiencing reductions in state aid, school districts were left with few alternatives but to utilize fund equity to balance their budgets if instructional quality was to be maintained. The early years of this downturn in school funding was easier to remedy with districts cutting back on a small scale to balance their budgets. After several years of eliminating non-essential expenditures, schools began to face tougher and tougher choices. Drawing down fund equity to keep budgetary

reductions away from the classroom diminished many districts' fund equity balance. Once fund equity is depleted, slashing essential instructional programs and services for students is the only way to balance the budget unless other revenue can be generated through enrollment. The level of fund equity is a good measure for district fiscal stress and trends among Michigan school districts fund equity will be examined.

The second key question is “what factors account for variations in fiscal stress from district to district?”

It is evident through a review of the data that some districts are successful at warding off a deficit while other districts with similar characteristics struggle on an annual basis to make the necessary budget reductions and revenue enhancements that keep that district operating at a functional level. My analysis seeks to assess various hypotheses regarding the causes of financial distress. Determining the factors that contribute to fiscal stress will help decisions makers determine if current operations in the district are financially sustainable or identify potential areas for improving resource allocation. This research will assess the extent to which financial strain is generated by district resource misallocation as opposed to factors largely beyond local district control. Many factors contribute to districts' financial condition, including: employee compensation levels, benefits offered, programs provided to students, class size, and costs of maintaining facilities. Key factors on the revenue side include districts' per-pupil foundation allowance, enrollment growth and property values. Finally, the level of fund equity that the district had on reserve prior to the start of the economic downturn

would be a factor in preventing fiscal stress because the fund equity would be relied on to balance the budget until the financial outlook of the state changed. My analysis will seek to determine the correlation of these and other factors with the size of districts' fund balance in order to help pinpoint both factors that contribute to fiscal stress and potentially steps that might be taken to improve district fiscal health.

Theoretical Discussion

A wide range of measures has been proposed for school districts to enhance revenue or reduce costs or increase their efficiency. To what extent financially strapped districts have attempted these various strategies and determining how effective they have been will gain an understanding of the factors that influence fiscal health. A preliminary review of district fund equity data suggests that some school districts are highly successful at maintaining and even enhancing their financial position in ways that go beyond the obvious solution of increasing enrollment, while other school districts with similar characteristics continue to experience reductions in their fund equity to dangerously low levels and in some cases into the negative.

On the revenue side, perhaps some districts do not participate in the school choice program or have limited participation because of the general philosophy of the district regarding educating students who are not district residents. Other districts may be stepping up campaigns to attract and retain students through the choice program and enhance their revenue through creative, entrepreneurial ventures. Another factor may be variations in the per-pupil foundation allowance. Districts that had high property values

on a per-pupil basis at the onset of Proposal A have a higher per-pupil foundation allowance than those districts with lower property values. Also, just by nature of their geographical location, some districts are gaining pupils and others are losing them. For example, students are leaving urban school districts in large numbers to attend neighboring school districts, which in turn prompts the migration of students from the neighboring districts even further out to the suburbs. Those districts that happen to be located on the borders of large urban and suburban areas are typically growing. This growth translates to increased revenue which aides in combating rising costs.

On the expenditure side, aligning district resources through the framework of the unified reporting requirements of the state will help determine the areas where schools may be over spending or under spending relative to similar districts. One of the factors that may contribute to variations in spending by district is average class size. The larger the class the less instructional costs are incurred because fewer classrooms and therefore fewer teachers, are necessary.

Another factor is average teacher salary. This factor is influenced by several conditions for instance, geographical location, the experience of the teaching staff, or the outcome of union contract negotiations. Typically a teacher in an urban area earns more than a teacher in a suburban area. An experienced teaching staff may cost more because they have progressed up the teachers' salary schedule and are more costly to the district than a less-experienced staff. Lastly, union contract negotiations influence the cost of salaries and benefits. Some districts are successful in negotiation less costly benefit packages or wage freezes or wage concessions when faced with budgetary constraints.

The final factor could be overall expenditure allocations in particular areas, such as administrative expenses, the costs of benefits, operations and maintenance costs or the cost of transportation. Perhaps a school district has high administrative costs or maintains an expensive benefit package for district employees. The infrastructure of a particular school system could be aging and therefore be costly to maintain. Some districts may have chosen to privatize some or all of their non-instructional functions such as food service, transportation and custodial and maintenance operations. Other districts may have been successful at negotiating shared costs between the school district and the employee for a portion of health insurance premiums. Finally, a district could be spread across a large geographical area, causing increased expenditures in the transportation area.

Identifying these revenue and expenditure variances aids in the understanding of the changing climate that helps enhance a school districts financial position or continues to prevent a school district from returning to fiscal health. A key component of this research will be to go beyond simple answers to the above questions and delve into the internal and external factors that caused districts to react as they did as the budget crisis progressed over time. This will be valuable as we attempt to understand the uniqueness of each school district. The school system is a reflection of community values, which are expected to differ from community to community. Exploring these dynamics and determining the factors that determine school budgets will data to gain an understanding of the long-term impact of a stagnant revenue stream.

Research Design

The research design is developed in a way that will both answer the questions posed above and delve into the explanations of what actually occurred that caused districts to react as they have to budgetary constraints. Furthermore, factors will be identified and the data will be summarized with overall observations from the information presented. At the state level, data for all school districts will be analyzed to determine trends in revenues, expenditures, and fund equity. In addition, a sample of school districts data gathered at the district level will help to determine where district resources are allocated and how much on a per-pupil basis will be designated for each area identified by function and object codes according to State guidelines. This expense allocation on a per-pupil basis will help identify areas with large variances of resource allocation between the districts. A key component of this study will be the trends in fund equity patterns for every district in the state and variances that are expected to occur between districts in a smaller sample.

Methods Used to Answer the Research Questions

The empirical work will be based on an analysis of the finances of all districts in the State of Michigan, plus a detailed study of the budgets and decision-making in a sample of six districts. Below are the methods that will be used to perform the research that will answer the identified questions.

Question 1: How has the fund equity as a percentage of general fund revenue changed over the past five years for all districts in the State of Michigan?

All school districts in the state will be studied to answer the first question. Data will be obtained from the Center for Educational Performance and Information's financial information database (FID) on fund equity levels for the fiscal years 2001-02 through fiscal years 2005-06 for all school districts in the State. All school districts are required to submit their financial information annually in the framework of the FID. The 2005-06 school year is the most recent data submission, but prior years will also be evaluated from the financial information database to gain a historical perspective on district revenue and expenditure characteristics. The historical analyses will show whether fiscal stress has become more or less severe among Michigan school districts over time and how many districts have gone into deficit.

Question 2: What factors account for variations in fiscal stress from district to district?

Two types of methods will be utilized to examine this question. First, a quantitative statistical analysis will be performed on a statewide level. Data obtained from the Center for Educational Performance and Information's FID will be used, as well as information obtained from the Michigan Department of Education's most recent *Bulletin 1014* which provides financial information for all Michigan school districts including:

Revenues

- Total revenue per pupil
- Enrollment
- Enrollment change from 2001 to 2006

Expenditures:

- Average class size (pupil/teacher ratio)
- Average teachers' salary
- Administrative expenditures as a share of current operating expenditures
- Operations and maintenance expenditures as a share of current operating expenditures
- Transportation expenditures as a share of current operating expenditures
- Employee benefits as a share of current operating expenditures

The analysis seeks to determine the correlation with multiple regression analysis between these factors, which will serve as the independent variable, relating to both revenues and expenditures and district fiscal health as measured by fund balance as a share of total general fund revenues and as a share of total general fund expenditures, with each of these serving as the dependent variable. The major focus will be on the dependent variable of fund equity as a share of general fund revenues. The dependent variable of fund balances as a share of total general fund expenditures is included for additional reference. Identifying these factors will help develop a profile of what some schools are doing right to maintain fiscal health.

Because not all information can be gleaned from reviewing financial data, a second method will be utilized to answer this question also. The second method will be

case studies of a smaller sample of school districts which provided a more in-depth review of individual school districts and will be conducted to determine what some school districts are doing to ward off or create fiscal stress. The environment that school districts in the State of Michigan are currently operating in would dictate that all schools feel pressure to generate new revenue through student enrollment and reduce expenditures with budget reductions. Depending on the severity of the financial situation, districts may become increasingly desperate to make difficult and deeper reductions to balance the budget. To determine what budgetary changes districts have implemented six districts were selected for an in-depth study.

School District Sample Selection

A survey was developed administered to all twenty-eight local school districts within Oakland County. Twenty-five of the twenty-eight school districts responded to the survey. This survey was designed to determine what, if any, cost savings measures or revenue enhancements measures have been implemented. Furthermore, from these twenty-eight school districts, a smaller sample of districts was chosen and a semi-structured interview with an interview tool was conducted with district business managers to acquire a more in-depth look at the reaction to budgetary stress in this smaller sample of districts. Six school systems ranging in size from 3,500 to 7,500 students were selected as the sample to also answer the second question. Two of those school districts were selected because of the strong financial position the school district is experiencing based on the fund equity percentage to overall revenues. Districts with fund

equity percentages of at least 15% are considered to be in good fiscal health. Two districts were chosen because their fund equity was at or near zero. Two other comparable school districts were chosen based on their fund equity position being in a deficit. Once a district has deficit fund equity, it is mandatory that the deficit district participated in the State of Michigan's deficit reduction program. Efforts were made to choose urban school districts with similar ethnic, racial and socioeconomic status and similar student achievement results. Choosing districts with essentially the same characteristics, other than fund equity levels will eliminate other factors as possible contributors to the financial health of the district. Some of the characteristics of school districts that could influence financial health are the school district setting because school districts in urban areas typically have a higher special education population, which would account for larger expenditures in this area. Schools in a rural setting typically have low population levels which don't accommodate a variety of course offerings and therefore would have a different expenditure pattern than an urban district. It is expected then that suburban school districts would be a blend of these two populations, but would also have unique expenditure patterns such as low transportation costs because of geographical size compared to rural districts that are required to transport students over long distances or urban school district that may rely on public transportation. Lastly, if a district is a large urban district, it might be explainable why a large percentage of resources are allocated to enhanced curriculum programs because students from large urban districts typically struggle with student achievement. Choosing school districts with similar characteristics controls for these other factors influencing the outcome of the study.

Data Collection Methods

Factors were analyzed to determine what changes these districts have made.

These factors are identified below:

Revenues

- Participation in Schools of Choice
- Enhance revenue by allowing advertising on school property
- Require students to pay a portion of the cost for extra-curricular activities

Expenditures

- Privatize non-instructional areas
- Require employees to contribute to a portion of the health insurance premiums
- Negotiate pay freezes or wage concessions
- Increase class size
- Reduce benefit offerings
- Eliminate programs or services
- Consolidation of Services

Analyzing these factors would provide information regarding how districts have responded to the funding crisis in the long-term. Comparing revenue enhancement ideas from district to district will determine what factors have been successful at generating additional revenue for cash strapped districts. Comparing expenditure reduction patterns from district to district may generate common areas that many schools have reduced in order to balance the budget but may also produce some inventive ways that some of the more successful districts have achieved financial stability.

Determining what school districts have done to either enhance their revenue or reduce their expenditures was discovered through the interview process. Particular attention was given to the unique pressures each school district felt to either implement a certain revenue generation plan or reduce certain programs or expenditures over others. It would be expected that preserving some programs while eliminating others as well as participating in revenue generation programs, such as Schools of Choice would be unique from district to district based on community values and preferences. The last three years final budget documents were also collected for each school district in the sample for further analysis.

Conclusion

The purpose of this research was to investigate factors that contribute to fiscal stress for school districts in order to establish a model using benchmarks for maintaining fiscal health. My analysis sought to determine the correlation of these and other factors with the size of districts' fund balance in order to help pinpoint both factors that contribute to fiscal stress and potentially steps that might be taken to improve district fiscal health.

It was not the expectation that the outcome would be a "one size fits all" model, but important factors that indicate fiscal health was identified. This research will also aid schools in determining if they are headed for fiscal stress and may help districts determine what factors are creating fiscal stress so that their course may be altered before running into a financial deficit.

CHAPTER IV

ANALYSIS OF FINANCIAL DATA

It would be expected that as the funding crisis in the State of Michigan continues, more and more districts would be utilizing fund equity to maintain competitive in the school choice environment by not eliminating course offerings, programs and extra-curricular activities. It would also be expected that school districts would begin to operate more efficiently as a result of the lack of resources during the ongoing funding crisis.

Table 1. School District Fund Equity Levels In The State of Michigan, 2001-2006

| Fund Equity Percentage | Number of Districts | | | | | Percentage 2005-06 Total | Percentage Change 2001-2006 |
|------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|--------------------------------|-----------------------------------|
| | Fiscal Year 2001-02 | Fiscal Year 2002-03 | Fiscal Year 2003-04 | Fiscal Year 2004-05 | Fiscal Year 2005-06 | | |
| > 20% | 208 | 190 | 186 | 159 | 123 | 22.4% | -40.9% |
| 16-20% | 82 | 89 | 93 | 104 | 98 | 17.9% | 19.5% |
| 11-15% | 102 | 112 | 106 | 114 | 110 | 20.0% | 7.8% |
| 6-10% | 95 | 90 | 115 | 94 | 122 | 22.2% | 28.4% |
| 0-5% | 54 | 62 | 40 | 65 | 78 | 14.2% | 44.4% |
| <0% | 8 | 6 | 9 | 13 | 18 | 3.3% | 125.0% |

RESULTS OF FUND EQUITY COMPARISONS

Table 1 shows that school district fund equities are declining as the financial downturn continues. In the first category, the range of fund equity is the fund equity level of greater than 20%. In the first year analyzed, the 2001-2002 school year, 208 (or 37.8% of Michigan's) school districts maintained 20% fund equity or greater. The share of districts with such a relatively comfortable financial cushion has progressively declined in each subsequent year. By 2005-06 only 123 school districts (22.4%) were still able to maintain a 20% or greater fund equity. The overall decline in this category over the five-year period was 40.8%.

In the second category, the range of fund equity is the fund equity level of 16% to 20%. In the first year analyzed, the 2001-02 school year, 14.9%, or 82 school districts, had fund equity between 16% and 20%. The share of districts with this somewhat relatively comfortable financial cushion has slightly increased in each subsequent year. By 2005-06, 98 (or 17.8% of Michigan's) school districts were able to maintain fund equity between 16% and 20%. The overall increase in this category over the five-year period was 19.5%.

The third category, the range of fund equity is the fund equity level from 11% to 15%. In the first year analyzed, the 2001-02 school year, 102 (or 18.57% of Michigan's) school districts maintained fund equity levels of between 11% and 15%. The share of districts that was able to maintain this average level of fund equity has not consistently increased throughout the five years, but instead has gone up and down through the five year's examined. However, by 2005-06, 110 (or 18.21% of Michigan's) school districts

were able to sustain this relatively healthy fund balance. The overall increase in this category over the five-year period was only 7.84%.

The fourth category range was the fund equity level of between 6% and 10%. In the first year analyzed, the 2001-02 school year, 95 (or 17.3% of Michigan's) school districts were maintaining this fairly modest level of fund equity. The share of Michigan school's at this level has also varied from year to year, with some years experiencing overall increases while others experienced decreases. This category finished the 2005-06 school year with 122 (or 22.22% of Michigan's) school districts in this relatively modest fund balance category. The overall increase in this category over the five-year period was 28.42%.

The fifth category range analyzed was the fund equity level between 0% and 5%. In the first year analyzed, the 2001-02 school year, 54 (or 9.8% of Michigan's) school districts maintained fund equity between 0% and 5%. The share of districts that consistently reported that dangerously low levels of fund equity also increased and decreased over the five years examined, settling at 78 (or 14.2% of Michigan's) school districts maintaining this low level of fund equity. The overall increase of districts in this range over the five year's examined was 44.44%.

In the final range, the districts that are maintaining fund equity levels below 0% are the districts that are experiencing deficit fund equity. Once a district reaches this negative level of fund equity, the State of Michigan requires that districts submit a deficit elimination plan to the Michigan Department of Education. In the first year analyzed, the 2001-02 school year, there were 8 (or 1.5% of Michigan's) school districts that had negative fund equity. The share of districts that maintained a deficit fund equity position

over the five year's examined did not consistently grow, but rather increased and decreased over the five year's examined, settling at 18 (or 3.27% of Michigan's) school districts maintaining this deficit fund balance position. The overall increase in this category was by far the largest increase of any category studied, with 125% increase at the end of the five-year period.

Table 1 clearly indicates that school districts fund equity levels have declined in recent years in Michigan. One would think that larger numbers of school districts would fall into the deficit range, but upon analyzing the data, only 10 additional school districts fell into the deficit range over the five-year span. This small increase would indicate that as districts fund equity declined, districts made expenditure reductions or increased revenue to maintain the lower levels of fund equity and but still stayed of the deficit fund equity range.

SUMMARY OF FUND EQUITY COMPARISONS

The only range of fund equity that declined over time was the 20% or greater fund equity range. All the other ranges experienced increases over the time span analyzed. The conclusion that can be drawn from analyzing the data, is that while the highest ranges is decreasing, the lower ranges are increasing as districts fell out of the highest ranges into the lower ranges. What can also be determined from analyzing the data is that districts are falling quickly through the ranges and not just falling from one range to the next, but in most instances, the fund equity is falling several ranges in one year. This can be determined by looking at the changes from the greater than 20% range from one

year to the next and comparing those changes to the increases in the lower ranges in the following years. For example, in the greater than 20% range between 2001-02 and 2002-03, the districts the decline in that ranges was the difference between the 208 districts in the first year to the 190 districts in the second year. That amounts to 18 school districts that fell out of the greater than 20% fund equity range. It would be logical to conclude that all of those districts fell directly into the range below, which is the 16-20% range. However, that range only increased by 7 school districts from 82 districts to 89 school districts in the 2002-03 school year. From that comparison, one can conclude that the other 11 districts fell into the ranges further below the 16-20% range, with 10 of them falling into the 11%-15% range. It is uncertain what ranges the remaining districts fell into because in the next range, the 6-10% range, actually experienced a decrease of 5 districts in the 2002-03 school year, not an increase as one would expect. The decrease in this range points to another fact in comparing the data. With the information that is provided, it is uncertain to determine if some districts' fund equities are growing, while others are declining because the data isn't tracked from district to district but as a group of 549 districts as a whole. Therefore, one cannot determine unequivocally that all districts fund equities are declining. Some may actually be increasing through the ranges, while others are declining through the ranges. One can conclude, however that as a whole, district's fund equity in the State of Michigan over the five-year period of 2001-2006 are declining.

RESULTS OF MULTIPLE REGRESSION ANALYSIS

The analysis seeks to determine whether there are systematic correlations between measures of school district fiscal stress and district resource allocation decisions. Two alternative measures of fiscal stress are employed: (1) fund balance/total revenue and (2) fund balance/current operating expenditures. District fiscal stress is inversely related to both measures – the larger a district’s fund balance relative to its total general fund revenues or its total expenditures, the less financially strapped the district is. These two variables serve as dependent variables in multiple regression models that include all Michigan School districts.

The regression models include a set of explanatory variables reflecting fiscal characteristics that have been cited as influencing district fiscal health. District “Enrollment” in 2005-06 measures whether there is any systematic relationship between district size and district fund balance. “% Enrollment Change” between 2001 and 2006 captures whether district growth or decline is systematically related to fiscal stress, with an expectation of a positive correlation. “Average salary” of teachers would expect to be negatively related to fund balances; while average class size (identified by the “Pupil/Teacher” ratio) should be positively related to fund balance.

Four explanatory variables assess the influence of districts’ resource allocation across various functions that have attracted considerable attention in recent years. “Admin Exp/COE” measures the share of district current operating expenditures devoted to administration. This is a measure of administrative bloat or bureaucracy and conventional wisdom and prevailing rhetoric suggest that it is inversely related to district

fund balances. “Transp Exp/COE” and “Oper & Maint Exp/COE” represent the share of current spending devoted to transportation and operations and maintenance respectively. District efforts to reduce costs by contracting out (i.e., privatizing) the provision of transportation or custodial services should be reflected in these two variables insofar as they are systematically related to district fiscal health. In both cases, I expect a negative relationship with district fund balance. Likewise, “Benefits/COE” measures the share of district expenditures devoted to employee benefits, with the expectation of declining fund balances with rising employee benefits.

Table 2 displays the models for Fund Balance/Total Revenues, and Table 3 presents the Fund Balance/COE regressions. In each case three models are estimated. The first model (Equation 1 in both Tables 2 and 3) includes only district enrollment, enrollment changes and per pupil revenue. The second model (Equations 2 in Tables 2 and 3) includes only the resource allocation variables. Equation 3 in both tables presents the full model.

Table 2. Influences of District Characteristics on District Fund Balance

| Dependent Variable: Fund Balance/Total Revenue | | | |
|---|----------------------|--------------------|----------------------|
| Explanatory Variables | 1 | 2 | 3 |
| Constant | 0.29** (7.44) | 1.24** (11.94) | 1.31** (12.16) |
| Enrollment | -4.74E-6** (2.84) | | -6.76E-9** (0.49) |
| % Enrollment Change | -0.01** (3.74) | | -0.01 (1.85) |
| Revenue/Pupil | -1.43E-5** (2.95) | | -1.05E-5** (2.67) |
| Admin Exp/Current operating expenditures | | -2.08** (5.92) | -2.13** (6.10) |
| Oper & Maint Exp/Current operating expenditures | | -1.94** (4.39) | -2.16** (4.76) |
| Transp Exp/Current operating expenditures | | -0.52 (1.42) | 0.52 (1.43) |
| Benefits/Current operating expenditures | | 0.38** (16.40) | 0.37** (16.11) |
| Average Salary | | -2.17E-6 (1.55) | 2.68E-6* (1.88) |
| Pupil/Teacher Ratio | | 0.03** (9.05) | -0.02** (7.66) |
| R ² | 0.05 | 0.44 | 0.45 |

Notes: Absolute values of t-statistics in parentheses

*significant at 95% level, **significant at 99% level

Table 3. Influence of District Characteristics on District Fund Balances
Dependent Variable: Fund Balance/Current Operating Expenditures

| Explanatory Variables | 1 | 2 | 3 |
|---|-------------------|---------------------|---------------------|
| Constant | 31.86** (8.80) | 154.09** (13.73) | 162.59** (14.18) |
| Enrollment | -0.01** (3.20) | | -0.12** (4.66) |
| % of Enrollment Change | -0.13** (4.31) | | -0.001** (2.96) |
| Revenue/Pupil | 0.002** (3.90) | - | -9.49E-5 |
| Admin Exp/Current operating expenditures | | -240.10** (6.33) | -81.10** (2.11) |
| Oper & Maint Exp/Current operating expenditures | | -232.99** (4.81) | -1.38** (0.56) |
| Transportation/Current operating expenditures | | -80.43* (2.03) | 0.01** (2.69) |
| Benefits/Current operating expenditures | | 0.20 (0.08) | -2.30** (7.14) |
| Average Salary | | 0.01* (2.27) | -249.88** (5.19) |
| Pupil/Teacher Ratio | | -2.69** (8.63) | -255.73** (6.89) |
| R ² | 0.07 | 0.27 | 0.31 |

Notes: Absolute values of t-statistics in parentheses

*significant at 95% level, **significant at 99% level

SUMMARY OF RESULTS OF MULTIPLE REGRESSION ANALYSES

The results in Tables 2 and 3 are largely consistent with one another, as one would expect. In general, the Fund Balance/Total Revenue models fit somewhat better than those standardizing district fund balance by expenditures. The full model (Equation 3) in Table 2 has an R^2 of 0.45 which is respectable for a cross sectional regression of this sort. The interpretation that follows focuses on the Table 2 results.

District fiscal stress is not significantly related to either district enrollment size or growth. Large districts are not systematically more or less likely to have low fund balances than smaller districts. Surprisingly, although it is not statistically significant in the full model, district enrollment change has the wrong sign. Per pupil revenue has a significant negative relationship with district fund balance.

The analysis also discovered that districts with higher foundation allowances on a per-pupil basis have lower fund balances, which is also the opposite of what one would expect. There are two likely explanations for this. First, high revenue districts tend also to be high cost districts and those differential costs (which by definition are beyond a district's control) have not been fully accounted for in the regression models. Second, the negative coefficient on Revenue/Pupil could simply be a statistical artifact, (spurious correlation) since total revenue is in the numerator of the explanatory variable and denominator of the dependent variable.

A comparison of Equations 1 and 2 in Table 2 clearly indicates that most of the explanatory power in the full model comes from the resource allocation variables to which I now turn. The clearest story here seems to be that districts that devote a larger

share of their spending to administration tend to have lower fund balances. The share of spending devoted to operations and maintenance expenditures also had a significant negative relationship with district fund balances in Table 2, but not in Table 3. In addition, districts that pay high average teacher salaries are those that have low fund equity levels. The results suggest that district efforts to reduce administration and operations and maintenance expenditures and teacher salaries will ease fiscal stress.

The share of expenditures devoted to transportation had an insignificant influence on district fund balances. Whatever cost reductions might be achieved through the privatization of transportation services, to date variations in district transportation expenditures do not account for the variations in the levels of fiscal stress.

The share of cost of expenditures devoted to operations and maintenance and transportation had an insignificant influence on district fund balances. Privatization of non-instructional costs, which is a popular expenditure reduction measure, has an insignificant affect of fund equity levels and therefore does not account for the variations in the levels of fiscal stress.

Two resource allocation variables in Equation 3 of Table 2 – Benefits/COE and Pupil/Teacher – have significant coefficients with the wrong, or unexpected, sign. Ordinarily, one anticipates that district fiscal stress increases as employee benefit expenditures consume a larger portion of revenues. On the other hand, one anticipates that smaller class sizes are an expensive luxury that tends to strain district budgets. The fact that Benefits/COE had a significant positive coefficient and Pupil/Teacher had a significant negative coefficient is most likely a consequence of reverse causation in the regression models. These regressions, after all, demonstrate correlation, not causation.

So the causation to some extent may run from the dependent to explanatory variables. Districts that have strong fund balances have been able to maintain employee benefits where as those that have experienced the most fiscal strain have been forced to curtail benefit expenditures. Similarly it is likely that districts experiencing fiscal stress have been forced to raise average class size, which accounts for the observed negative correlation on Pupil/Teacher.

CHAPTER V

ANALYSIS OF SURVEYS AND INTERVIEWS

Survey Results

The purpose of this chapter is to present and analyze the findings of the surveys and interviews conducted. What we have learned from the statewide overview is that district's fund equity levels are declining in general, but this broad overview doesn't shed light on specific district behaviors. This research seeks to analyze behaviors and identify patterns in the adoption of practices, if such patterns exist. Furthermore, why a district adopted one particular budget reduction or revenue enhancement measure while rejecting another will be answered, which options produced results, and the effectiveness of each option.

Because not all information can be gleaned from reviewing financial data, a second method was utilized. This method involved a more in-depth review of individual school districts and was conducted to determine what specific districts did to ward off or create fiscal stress. A survey was administered to all 28 school districts in Oakland County. Of the 28 school districts, 25 responded to the survey. I first analyzed revenue enhancement measures taken by these districts, and then turned to an analysis of specific expenditure reduction measures.

Revenue Enhancements

The survey asked district business managers to indicate which, of four common revenue enhancement measures, they have implemented. Table 2 displays the results for the 25 responding school districts.

Table 4. Revenue Enhancements by District

| | Revenue Enhancements | | | |
|--------------|----------------------|---------------|--------------------|---------------|
| | Schools of Choice | Advertising | Pay to Participate | Other |
| Avondale | Yes | No | Yes | No |
| Berkley | Yes | Yes | Yes | Yes |
| Birmingham | No | No | Yes | Yes |
| Brandon | Yes | No | Yes | Yes |
| Clarkston | No | No | Yes | No |
| Clawson | Yes | No | Yes | Yes |
| Farmington | Yes | No | Yes | Yes |
| Ferndale | Yes | No | No | No |
| Hazel Park | Yes | No | No | No |
| Holly | Yes | No | Yes | No |
| Lake Orion | No | Yes | Yes | No |
| Lamphere | Yes | No | No | Yes |
| Madison | Yes | No | No | Yes |
| Novi | No | Yes | Yes | Yes |
| Oak Park | Yes | No | No | Yes |
| Oxford | Yes | No | No | No |
| Pontiac | Yes | No | No | Yes |
| Rochester | No | Yes | Yes | Yes |
| Royal Oak | Yes | Yes | No | Yes |
| South Lyon | Yes | No | Yes | No |
| Southfield | Yes | No | No | Yes |
| Troy | Yes | No | No | Yes |
| Walled Lake | Yes | Yes | Yes | No |
| Waterford | Yes | Yes | No | Yes |
| W Bloomfield | Yes | Yes | Yes | Yes |
| Yes | 20 | 8 | 14 | 16 |
| No | 5 | 17 | 11 | 9 |
| Total | 25 | 25 | 25 | 25 |
| % Yes | 80.00% | 32.00% | 56.00% | 64.00% |

Schools of Choice

Participating in the Schools of Choice is the largest revenue producer a school district can embark on. Under Michigan's system of school finance, the more students a school district has enrolled the more revenue it has to operate. Some districts are hesitant to participate in Schools of Choice because it is a controversial issue. Advocates maintain that it is unfair to force parents – and especially poor parents – to send their children to schools that are failing or to schools they dislike with no other option for them. The opportunity to choose a preferred school should be available for all parents, not just middle and upper-class ones. In addition advocates maintain that market competition and discipline will improve the performance of all school districts. Opponents argue that non-resident students unfairly benefit from bond issues and other improvements funded by resident taxpayers. Furthermore, non-resident students may change the socioeconomic or racial composition student population in ways opposed by local residents. The survey results indicate that participation in the Schools of Choice program is a popular revenue enhancement option in Oakland County, with 80% of districts participating in the program. Only five out of the 25 school districts chose not to participate in the Schools of Choice program. Families in each of these districts are relatively affluent. With the exception of Birmingham, these districts are also relatively fast growing communities on the outer periphery of suburban Detroit.

Advertising on District Property

The other revenue enhancement measures--advertising, paying to participate in athletics and extra-curricular activities and other miscellaneous revenue enhancement opportunities--generate smaller amounts of revenue for school districts. Advertising on school district property is not without controversy either. Typically, school districts advertise inside of school buses or around the perimeter of their athletic fields. These contracts with advertisers generate smaller amounts of revenue, typically under \$100,000 annually, and are also controversial because parents have concerns about having their children being subjected to marketing. From the survey results, advertising on school district property is not a popular revenue enhancement alternative, with only 32%, or 8 out of 25, school districts participating in some form of advertising on district property.

Pay to Participate

Some school districts also charge a fee for students to participate in athletics or extra-curricular activities. This revenue enhancement typically ranges from \$50 to \$600 per family annually, with varying amounts charged for middle school and high school athletics or extra-curricular activities, and caps on the total amount that a family must pay. Some stakeholders are in disagreement with this because pay to participate fees could exclude some students from low socio-economic backgrounds from participating in athletics or extra-curricular activities because they cannot afford the participation fee. The survey indicates that participation fees are a somewhat popular revenue enhancement measure 14, or 56%, of the school districts charging fees for athletic or extra-curricular activity participation.

Other Revenue Enhancements

Lastly, the other revenue enhancement activities, while creative, do not generate large amounts of revenue districts. These additional revenue enhancements include increasing lunch prices, starting a day care program, raising building rental fees and renting out cell tower space. The survey indicates that 16, or 64%, of the school districts utilize some form of miscellaneous revenue enhancements.

Expenditure Reductions

The survey conducted county wide, expenditure reductions were also analyzed. Below are the survey results of those twenty-five districts that participated in expenditure reductions. Nine common expenditure reductions were analyzed to determine what components of expenditure reductions were implemented to reduce the budgetary expenditures.

Table 5. Expenditure Reductions by District

| | Privatize | Pay | Freeze or | Increase |
|--------------|--|---------------|------------------|-----------------|
| | Insurance Concession Class Size | | | |
| Avondale | Yes | Yes | Yes | Yes |
| Berkley | Yes | Yes | Yes | No |
| Birmingham | Yes | No | No | No |
| Brandon | Yes | No | No | No |
| Clarkston | No | No | Yes | Yes |
| Clawson | Yes | No | No | No |
| Farmington | No | Yes | No | Yes |
| Ferndale | Yes | Yes | No | No |
| Hazel Park | Yes | No | Yes | No |
| Holly | Yes | Yes | Yes | No |
| Lake Orion | No | No | No | No |
| Lamphere | No | Yes | No | No |
| Madison | No | No | Yes | No |
| Novi | No | No | Yes | No |
| Oak Park | Yes | No | Yes | Yes |
| Oxford | Yes | Yes | No | No |
| Pontiac | Yes | No | Yes | No |
| Rochester | No | Yes | Yes | Yes |
| Royal Oak | Yes | Yes | No | No |
| South Lyon | Yes | Yes | Yes | Yes |
| Southfield | Yes | No | Yes | Yes |
| Troy | Yes | No | No | No |
| Walled Lake | Yes | Yes | Yes | Yes |
| Waterford | Yes | No | No | No |
| W Bloomfield | Yes | No | Yes | No |
| Yes | 18 | 11 | 14 | 8 |
| No | 7 | 14 | 11 | 17 |
| Total | 25 | 25 | 25 | 25 |
| % Yes | 72.00% | 44.00% | 56.00% | 32.00% |

Table 6. Expenditure Reductions by District, Continued.

| | Expenditure Enhancements | | | | |
|--------------|---------------------------------|---------------------------|------------------------|-----------------------------|-----------------------------|
| | Reduce Benefits | Eliminate Programs | Eliminate Admin | Eliminate Principals | Consolidate Services |
| Avondale | No | No | Yes | Yes | Yes |
| Berkley | No | Yes | Yes | No | Yes |
| Birmingham | Yes | No | Yes | Yes | Yes |
| Brandon | No | Yes | No | No | No |
| Clarkston | No | No | No | No | No |
| Clawson | No | No | No | No | No |
| Farmington | No | Yes | Yes | No | Yes |
| Ferndale | Yes | No | Yes | Yes | Yes |
| Hazel Park | Yes | No | No | Yes | No |
| Holly | No | Yes | Yes | Yes | Yes |
| Lake Orion | Yes | Yes | Yes | No | No |
| Lamphere | No | No | No | No | No |
| Madison | No | No | No | No | No |
| Novi | Yes | No | Yes | No | No |
| Oak Park | Yes | No | Yes | Yes | No |
| Oxford | No | Yes | No | No | Yes |
| Pontiac | Yes | Yes | Yes | Yes | Yes |
| Rochester | No | No | Yes | No | Yes |
| Royal Oak | No | No | Yes | Yes | No |
| South Lyon | No | No | Yes | No | No |
| Southfield | No | Yes | No | No | No |
| Troy | Yes | No | No | No | No |
| Walled Lake | No | Yes | Yes | No | Yes |
| Waterford | No | No | Yes | Yes | Yes |
| W Bloomfield | Yes | No | Yes | No | No |
| | 9 | 9 | 16 | 9 | 11 |
| | 16 | 16 | 9 | 16 | 14 |
| | 25 | 25 | 25 | 25 | 25 |
| | 36.00% | 36.00% | 64.00% | 36.00% | 44.00% |

Privatizing Non-Instructional Staff

Keeping the budgetary reductions away from the classroom has become the mantra of school districts as they respond to heightened fiscal pressures. Privatizing non-instructional services by contracting their provision through an external private company is one of the most widely discussed cost-cutting strategies. Key areas for contracting include food, transportation, and custodial and maintenance services. Other popular areas to privatize are substitute teachers, substitute clerical workers, paraprofessionals and coaches. The costs that can be avoided by privatizing non-instructional costs are the matching payroll FICA taxes and the mandatory retirement contributions to the Michigan Public School Employees Retirement System (MPERS). These two required payroll contributions total almost 25% of the gross payroll. This doesn't mean that the district can expect to save 25% over current costs. These savings are negotiated by the contracted company and vary from district to district.

Privatizing non-instructional services is controversial partly because of the way the MPERS functions. Current employees' contributions are funding current retirees' pensions. With fewer current employees funding the actuarially based retirement plan, may make the district contributions increase to keep pace with current retirees' pensions, thereby increase the retirement rate to districts. Another controversial issue surrounding non-instructional service privatization is that it may lower the earnings and/or benefits of former district employees, who may be residents of the community and less inclined to support the district with bond issues and other initiatives. School boards are reluctant to vote to privatize the jobs of their neighbors and school district supporters in the name of cost savings. The survey results indicate that some form of privatization is occurring in

74% of school district in Oakland County with 18 out of 25 school districts privatizing at least one non-instructional service. Some school districts have been successful in privatizing all non-instructional services while other districts have privatized only one or two areas.

Employees Contribute to Health Insurance Costs

Requiring employees to pay a portion of the health insurance premium is another option for school districts to curtail the rising costs of providing health insurance to district employees. Most non-administrative employees work under some kind of union contract. The portion of the health insurance premiums paid by employees is negotiated with the appropriate union groups. One of the arguments against increasing school employees' share of health insurance costs is that their salaries are generally lower than those of similarly trained employees in other occupations. One reason the salaries are low is that the health insurance plan school district employees enjoy are considerably more generous than the health insurance plans provided to other groups. However, health insurance costs have been increasing in double-digit percentages for several years, which dramatically increased the cost of providing health insurance to school district employees. The cost of employee benefits is typically the second largest expenditure, next to salaries, that school districts incur. Requiring employees to be responsible for a small portion of the health insurance premium is something that school districts have been negotiating in employment contracts in recent years. According to the survey, 44%, or 11 out of 25 school districts surveyed, require that employees contribute at some level to employee health care costs.

Reduce Employee Benefit Offerings

Reducing employee benefit offerings is another way that school districts are able to reduce expenditures without affecting student learning. There are a variety of ways that school districts are able to accomplish a benefit reduction. Some districts raise prescription drug card co-pays or office visit co-pays, which in turn reduces the insurance premiums that districts are required to pay. One way that districts have reduced the impact of these increased co-pays is to compensate the employee for the difference. Another way districts reduce benefit offerings is to eliminate the types of procedures or limit the types of services covered under the specific health insurance plan. For instance, annual physicals may no longer be covered because they are considered preventative, or chiropractic care may be completely eliminated from the health insurance plan. Other districts have turned to self-insurance for certain aspects of health care coverage, like dental or vision. This completely eliminates the cost of health insurance premiums for those types of coverage, but also increases the risk to school districts for large expenditures that could be incurred on behalf of district employees. Based on the survey results, this is not a popular choice for balance district budgets, with only 36%, or 9 out of 25 school districts choosing this as a viable option for balance district budgets.

Wage Freezes or Concessions

As noted, salaries represent districts' largest overall cost. Over the years of this economic downturn, districts have been negotiating smaller and smaller percentage increases in employee salaries. Some districts in financial distress have negotiated pay freezes or even salary concessions where employees are obligated to return earnings that have been paid to them. This is an extreme measure that some districts are forced to turn

to in order to align their expenditures with district revenues. Wage freezes or concessions impair employee morale because employees are required to either forgo a pay increase in one or several years, or return a portion of the pay increases they have enjoyed in the past, while the cost of living increases annually. The effect of the wage freezes or concessions is that the employee, from a financial perspective, is sliding backwards. Upon review of the survey results, 11 out of 25 school districts have required at least one employee group to either freeze their pay or take a wage concession. This represents 56% of all districts that participated in the survey.

Increasing Class Size

Increasing class size is another way that districts are able to reduce expenditures. By placing more students in each classroom, fewer teachers are required to deliver instruction. This is also controversial because research suggests that small classes enhance student achievement especially in the elementary grades. For this reason, district administrators are reluctant to increase class size. Increasing class size is in direct conflict with the concept of keeping the reductions as far away from the classroom as possible. This reduction is placed directly in the classroom. Class size is usually determined through contract negotiations with class size limits written into the labor contracts. The survey confirms that this is not a popular position for districts to take. According to the survey, 32% of districts have increased class sizes at some level to reduce costs. This represents only 8 out of 25 school districts that have increased class size.

Eliminating Programs or Services

In an effort to reduce costs, some districts turn to the option of eliminating programs or services. As in increasing class size, this reduction typically hits directly in the instructional area, which makes it an unpopular area for reduction. The districts that did make reductions in programs or services cited eliminating police liaisons, foreign language and music at the lower elementary levels and reducing paraprofessionals. These reductions aren't directly related to the core instructional areas. Even though some districts have chosen to eliminate programs or services, most of them choose to reduce in areas that would have minimal impact on student achievement. According to the survey results, eliminating programs and services was not a popular area to reduce district expenditures, with only 36%, or 9 out of 25 districts choosing this as an option.

Reduce Administrative Positions

Once a school district begins to experience fiscal stress, the district will begin to evaluate areas where reductions can be made. Many stakeholders typically favor reductions in administration instead of in the instructional area. Administration makes budget reduction recommendations to the school board. The school board usually looks to the administration for reductions in the administrative area first before moving to reductions in the instructional area. Therefore, it only makes sense that a large percentage of survey respondents reported reductions in administrative costs. This area was the second most popular area for budget reductions next to privatizing non-instructional services, with 64% or 16 out of 25 districts reporting administrative reductions as a way to reduce expenditures.

Reduce Building Principals

Enrollment declines may prompt districts to seek expenditure reductions by closing school buildings, typically at the elementary level. When buildings are closed, the building principal is no longer needed. Even if an entire building isn't closed, enrollment may drop to levels that only require one principal instead of a principal and an assistant principal, for instance. According to the survey results, reducing the number of principals has occurred in 36% of the districts surveyed, or 9 out of 25 districts.

Consolidation of Services

On September 19, 2007, Public Act 63 was enacted by the Michigan Legislature that required intermediate school districts to conduct a study to identify opportunities for sharing services among their local constituent districts. Because of this recent interest in service consolidation was included in the survey. Oakland County is somewhat unique in that many special education services are provided on a county-wide basis, with individual local school districts providing services based on the disability. Furthermore, some special education busing consortiums are active in Oakland County between several local school districts. Even though this is a new initiative, 44% of survey respondents, or 11 out of 25 districts have reported some type of consolidation of services with other districts. Most of the respondents who are participating in consolidation of services cited some type of transportation or technology services sharing.

Average Fund Equity Comparisons

Now that we have gained an understanding as to what degree of revenue enhancement measures and expenditure reductions have been implemented, next this study will look at making connections between practices adopted and the level of fund balance of a particular district. Simply put, theory would lead us to believe that the greater the number of revenue enhancements and expenditure reductions that have been implemented, the higher a district's fund equity level. Table 7 is a comparison of average fund equity levels between districts that did or did not choose to implement particular measures.

Table 7. Average Fund Balance of Participants Versus Non-Participants

| Average Fund Balance/ | |
|-------------------------------|-----------------------|
| District Action | Total Revenues |
| <i>Revenue Enhancements</i> | |
| Schools of Choice | |
| Participated | 8.0% |
| Did Not Participate | 20.0% |
| Advertising | |
| Participated | 13.9% |
| Did Not Participate | 8.8% |
| Pay To Participate | |
| Participated | 13.1% |
| Did Not Participate | 7.0% |
| Other | |
| Participated | 11.1% |
| Did Not Participate | 9.2% |
| <i>Expenditure Reductions</i> | |
| Privatize support services | |
| Yes | 8.9% |
| No | 14.3% |
| Pay Insurance | |
| Yes | 11.6% |
| No | 9.4% |
| Wage Freeze or Concession | |
| Yes | 7.1% |
| No | 14.5% |
| Increase Class Size | |
| Yes | 12.3% |
| No | 9.5% |
| Reduce Benefits | |
| Yes | 10.1% |
| No | 10.6% |
| Eliminate Programs | |
| Yes | 11.8% |
| No | 9.6% |
| Eliminate Administration | |
| Yes | 10.9% |
| No | 9.4% |
| Eliminate Principals | |
| Yes | 7.3% |
| No | 12.1% |
| Consolidate Services | |
| Yes | 10.2% |
| No | 10.6% |

Analysis of Revenue Enhancements

Schools of Choice Program

The first revenue enhancement measure analyzed was the participation in the schools of choice program. As we previously noted, only 5 school districts of the 25 surveyed choose not to participate in schools of choice. This high level of participation is expected, since the schools of choice program has the ability to increase revenues more substantially than any other revenue enhancement option. Therefore, one would expect that those that participate would enjoy higher fund equity levels than those that did not. However, upon review of the results of the fund equity levels of the participants compared to non-participants, it is apparent that the districts that participated in the schools of choice program had an average fund equity balance of 8% and those that did not participate had a 20% fund equity balance.

The results of this particular measure prove to be exactly the opposite of what one would expect. This high level of fund equity despite not participating in schools of choice could have several different explanations. Perhaps the districts with low fund equity have decided to participate as a desperate measure to increase their low fund equity levels. Another explanation could be that the 5 districts that choose not to participate, Birmingham, Clarkston, Lake Orion, Novi and Rochester have high levels of per-pupil foundation allowance and this keeps their fund equity level high. Another conclusion could be the schools of choice program is a sum zero proposition, with as many resident students leaving choice districts who participate as non-resident students enter.

Advertising

The next revenue enhancement measure that was analyzed was advertising. Districts have resorted to advertising on district website, school property such as athletic fields, and inside school buses to generate additional revenue. Of the 25 districts analyzed, only 8 out of the 17 districts have generated revenue by means of advertising. The districts that have generated revenue by advertising had an average 13.9% fund equity, while the districts that chose not to participate in any type of advertising endeavor had an average 8.8% fund equity balance. The percentage difference between these fund equity levels is fairly significant, and can't be explained by just advertising alone. Advertising generates only a small amount of revenue in all cases, under \$100,000. This amount would have a fairly insignificant influence on fund equity percentages. Therefore, one could conclude that while advertising does generate additional revenue and contributes to an increase in fund equity levels, advertising does not explain the larger average percentage of fund equity that exist in the districts that participate in advertising. However, districts that do generate additional revenue by advertising to enjoy a larger fund equity percentage than those districts that do not chose to advertise.

Pay to Participate

The third revenue generation measure that was analyzed was charging students to participate in athletic events and extra-curricular activities. This measure is commonly known as "pay to participate" in the academic environment. Of the 25 districts surveyed, 15 districts chose to participate in some form of charging students to participate in athletics and activities, while 10 districts did not. The average fund equity percentage of the districts that chose to charge was 13.1%, while the average fund equity percentage of

the districts that did not charge was 7.0%. The revenue that is generated by charging students to participate is fairly insignificant compared to the overall district's total revenue and could not explain the large difference in the variance between the districts that do charge and the districts that do not charge. One can conclude that though charging students to participate in athletics and activities does generate revenue, and the districts that do charge students enjoy a larger fund equity percentage than those districts that do not. However, charging to participate in athletics and activities does not explain the larger average percentage of fund equity that exists in the districts that charge.

Miscellaneous Revenue Enhancements

The last revenue enhancement measure that was analyzed was a miscellaneous category of revenue generation ideas. The participants were asked if they chose any other revenue enhancement measures besides the ones that were posed in the survey. A variety of measures were reported, from increasing the rental fee for building usage to renting space for cell tower companies to put towers on district property. Of the 25 school districts that were surveyed, 16 participated in some other variety of revenue production measures, while 9 did not. The districts that generated revenue through other measures had an average fund equity level of 11.1%, while the districts that implemented no additional revenue generation measures had an average fund equity level of 9.2%. The revenue that is generated from other measures only produces a small amount of additional revenue and could not explain the variance in fund equity percentages between the districts that have implemented other revenue enhancements measures and the districts that have not. One could conclude that though additional revenue enhancements measures increase fund equity level percentages, additional revenue enhancement

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measures do not contribute significantly to the variance between the districts that do generate additional revenue from other measures and those that do not.

Analysis of Expenditure Reductions

Privatization

A variety of expenditure reductions measures were analyzed as well. The first measure analyzed was if school districts privatized any of their non-instructional services, such as transportation, food service and operations and maintenance. Of the 25 districts surveyed, 18 had privatized at least one non-instructional service areas, with the remaining 7 districts choosing not to outsource any services. This was the most popular expenditure reduction choice of all measure analyzed. Of the 18 districts that did choose outsourcing, the average fund equity balance was 8.9% and of the districts that didn't choose to outsource, they had a 14.3% average fund equity balance.

The choice to privatize non-instructional services is a very difficult decision for school districts to make. There is a great deal of pressure internally and externally to retain district employees. When districts make the choice to privatize, it is not a decision that is made lightly and is typically made once a variety of cost cutting measures have already been implemented. There is a great deal of savings to be garnered from such privatization, because districts aren't required to pay payroll costs associated with employees once the district privatizes. It would be logical to conclude that the districts that have chosen privatization would enjoy a larger percentage of fund equity than the districts that have not made that choice. However the results of the analysis show just the

opposite. Districts that have chosen to privatize have a smaller fund equity level than districts that have not privatized.

There are many conclusions that can be drawn from analyzing the fund equity levels of districts that have chosen privatization and those that have not. One conclusion could be that districts with lower fund equity become increasingly more desperate to maintain their fund equity levels and make the difficult decision to privatize their own employees and that districts that enjoy higher levels of fund equity have yet to be faced with the more increasingly difficult budget reduction decision. Another conclusion could be that the fund equity levels of the districts that have chosen privatization have done so in an effort to either stay out of deficit or maintain their low levels of fund equity and without such a measure more districts would be in deficit or have a significantly lower fund equity than if that choice had not been made.

Payment of Health Insurance Premiums

Another expenditure reduction measure that was analyzed was whether school district employees are required to pay a portion of the health insurance premiums. Of the 25 school districts surveyed, 11 out of the 25 chose to require their employees to pay a portion of the health insurance premiums, while 14 of the 25 did not. Upon review of the corresponding levels of fund equity between the two groups, the districts that chose to require their employees to pay a portion of the health insurance premiums had an 11.6% average fund equity percentage and the districts that did not require their employees to pay a portion of the health insurance premium had a 9.4% fund equity percentage.

Obviously paying a portion of health insurance contributes improves the financial position of school districts. The conclusion that can be drawn from analyzing this

measure is that though districts that require their employees to pay higher percentage of health insurance premiums enjoy a larger fund equity percentage, it is not a large variance. Therefore, require employees to contribute to health insurance costs increases fund equity levels, but not to a large degree.

Wage Concessions or Freezes

Negotiating pay concessions or pay freezes was another expenditure reduction measure that was analyzed. Of the 25 school districts, 14 districts negotiated pay concessions or freezes and 11 school districts did not. A review of the corresponding fund equity levels of these two groups show that the districts that were successful in negotiation pay concessions or pay freezes had a 7.1% average fund equity percentage, and the districts that did not had a 14.5% fund equity percentage.

It would be logical to conclude that the districts that were successful negotiating wage freezes would enjoy a higher level of fund equity than those that were not, but this was not the case. The ability to successfully negotiate a pay concession or a pay freeze has the impact of flattening or even reducing the cost of salaries. Because of the labor-intensive environment, salaries are the largest cost that a school district incurs. Having the ability to keep this large cost flat, or even reduce the cost of the biggest expense component has a large impact on a district's financial position, particularly when the revenue stream has remained relatively flat. The conclusion that can be drawn from analyzing this particular expenditure reduction measure is that those districts that were successful in implementing a pay concession or pay freeze had a higher percentage of average fund equity than if they were not able to garner these cost savings. However, the districts that did not implement such concession still enjoyed a larger average fund equity

percentage than those that did. One explanation could be that the districts that have implemented this measure were already experiencing lower fund equity levels which forced them to resort to freezing or reducing salaries just to keep the district from either going into a deficit, or experiencing significantly lower fund equity levels than they would have experienced had this measure not been implemented.

Increased Class Size

Another expenditure reduction measure analyzed was if school districts increased class size in an effort to improve their financial outlook. Of the 25 school districts that were analyzed, 8 increased their class sizes, while 17 did not. Upon review of the corresponding average fund equity of these two groups, the districts that increased class size had an average fund equity percentage of 12.3%, while the group that did not increase class size had a 9.5% fund equity percentage.

As previously stated, salaries are the largest cost component of a school district. Increasing class sizes results in fewer teachers on district payrolls. Reducing salary costs has a large impact on the financial position of a school district. The conclusion to be drawn is that districts that were able to reduce staffing levels by increasing class size enjoyed a higher level of fund equity percentage than the districts that did not increase class size. Many districts are bound by the language in labor contracts and without negotiations are unable to increase class size beyond the contractual amounts.

Reduction of Benefit Offerings

Reducing the benefit package that is offered to district employees was another expenditure reduction measure that was analyzed. Of the 25 school districts surveyed, 9

reduced benefits while 16 did not. A review of the corresponding fund equity levels of the districts that reduced benefits and those that did not show that the districts that did reduce benefits had a 10.1% average fund equity level, while the ones that did not had a 10.6% fund equity level.

Next to salaries, benefit costs are the second largest expense component of school district operations. Any effort to reduce this cost would therefore have a large influence on fund equity levels. It would be logical to conclude that the districts that were able to reduce this cost component would experience a larger fund equity percentage than the districts that were not able to contain the costs of this component. However, when reviewing the average fund equity percentage there is not a significant difference between the fund equity percentages of the districts that were able to reduce benefit offering compared to the districts that were not. An explanation for this outcome could be that had the districts that reduced benefit costs not implemented this expenditure reduction measure, their fund equity levels would be significantly lower than if they hadn't, and the districts that haven't yet implemented a benefit reduction would be experiencing a higher level of fund equity if they had offered a reduce benefit package.

Elimination of Programs and Services

Despite the mantra of keeping budget reductions away from the classroom, a difficult economic environment causes districts to review all aspects of operations. Districts often decide to eliminate programs or services that may not have high participation levels in an effort or directly impact student learning to balance the budget. Of the 25 districts surveyed, 9 districts chose to eliminate programs or services while 16 did not. Did the decision to eliminate programs or services have a significant affect on

fund equity levels? A review of the corresponding fund equity levels show that the districts that eliminated programs or services had an average fund equity of 11.8%, while the districts that did not eliminate any programs or services had a 9.6% average fund equity.

The outcome of these results is what one would expect to find. In an attempt to balance the budget, districts would begin eliminating programs or services that had the potential of costing the district money and didn't impact core instruction, for instance on-site employee day care, police liaisons or community education programs. These reductions aren't directly related to the core instructional areas and have the result of reducing district expenditures without directly impacting student learning. From the analysis one could conclude that districts that eliminated programs enjoyed a higher average fund equity percentage than the districts that continued to maintain programs that were an additional expense to the district.

Reduce Administrative Positions

During times of fiscal crisis, a popular outcry from the community is to reduce administration rather than teaching staff. Therefore, this expenditure reduction measure is the second most popular area for budget reductions next to privatization of non-instructional services. From the survey respondents, 16 of the 25 districts chose to eliminate administration, while 9 did not. Reviewing the average fund equity level percentages, the districts that eliminated administration had 10.9% average fund equity and the districts that chose not to eliminate administration had 9.4% average fund equity. Thus, those districts that chose to eliminate administration have a larger fund equity

percentage and one could conclude that reducing administrative expenses is an effective way to increase fund equity levels.

Reduce Building Principals

Another way that districts look to reduce their non-instructional costs is to reduce the amount of building level supervision currently on staff, namely the principals. This reduction is difficult to implement because even though enrollment is declining, unless buildings are closing, each building still needs at least one principal. Of the districts surveyed, 9 of the 25 districts surveyed chose to eliminate building principals and 16 of the 25 did not. Most of these reductions came as a result of building closures related to declining enrollment, or a reduction of assistant principals in some buildings that were experiencing enrollment decreases.

Comparing the percentages of fund equity between the groups who have eliminated principals and those that have not, those that reduce principals had a 7.3% fund equity level and those that did not eliminate principals had a 10.1% fund equity level. It would be reasonable to believe that if principal reductions were taking place, that fund equity levels would be larger than if they were not, however the results of the analysis show just the opposite. One of the reasons for the variance could be that as enrollment declines, so does revenue and therefore fund equity. As a result of this declining enrollment building level supervision is also reduced. In other words, the decision to reduce a principal could come as a result of the enrollment decline, which reduced fund equity, instead of reducing principals to enhance the fund equity position.

Consolidation of Services

Recent attention has turned to the consolidation of school districts services.

Legislation has even been enacted to require districts to review opportunities to consolidate services with other school districts. Despite that fact that this is a fairly new initiative, 11 out of the 25 school districts have already implemented some kind of consolidation of services with other school districts, while 14 have not. Most of the consolidation of services is a result of the special education needs within local school districts. It is less costly for a to provide a joint classroom of students with the same disability than to each run separate individual classrooms. Furthermore, many districts were already participating in consolidating special education transportation as an effective measure to reduce costs.

Based on the analysis of the average fund equity levels of the districts, the districts that are participating in some form of consolidation of services have a 10.2% fund equity level, while the districts that do not participate have a 10.6% fund equity level. Again, these are not large variances between the groups, but one could conclude that the consolidation of services occurred because the consolidated alternative was less costly than the original method of service delivery and therefore, contributed to an increase in average fund equity percentages than if the district had not participated, and consequently, the districts that do not participate in some form of consolidation of services would enjoy a larger average fund equity percentage if they chose to participate.

Conclusion

This research attempts to identify patterns of behaviors that exist between districts with high fund equity levels and those with low fund equity levels. Based on the patterns that are identified in Table 7, it appears that the districts who have generated revenue from advertising, charging students to participate in athletics or activities, and have found alternate ways to generate revenue besides participating in schools of choice have the high fund equity levels.

On the expenditure side, those districts that have reduced their budgetary expenditures by requiring employees to pay a portion of health insurance costs, increasing class size, eliminating programs and services and eliminating administration have higher levels of fund equity than those districts that chose not to implement these measures. However the districts that chose to privatize non-instructional services, freeze wages, reduce benefits, eliminate principals and consolidate services have a lower fund equity percentage.

The results show that patterns of behaviors do not exist between schools with high fund equity levels and those with lower fund equity levels. For example, it would be reasonable to expect that the districts that have participated in schools of choice would have a higher fund equity level than those that did not. Likewise, those districts that have privatized non-instructional costs should have a higher fund equity level than those that did not.

Interview Results

From the 25 surveyed school districts, a sample of six was chosen for further analyses through interviews with their business managers. These semi-structured interviews provided a more in-depth look at districts' reaction to budgetary stress. Six school districts ranging in size from 1,800 to 8,100 students were selected. Two of these school districts had strong financial positions based on the fund equity percentage to overall revenues. Districts with fund equity percentages of at least 15% were considered in good fiscal health. Two districts were chosen because their fund equity levels were at or near zero. Two districts were chosen because their fund equity levels were in a deficit. The two districts that were chosen because they were in good financial health were Clarkston Community Schools and the Royal Oak School District. The two districts that were chosen because they were at or near zero fund equity levels were Avondale School District and Berkley School District. The two districts that were in a deficit were Oak Park City School District and Madison Public Schools.

Table 8. Fund Equity Percentages of Surveyed Districts from 2001-2006

| District Name | 2001- 2002 | 2002- 2003 | 2003- 2004 | 2004- 2005 | 2005- 2006 | 5 Year Average |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|---------------------------|
| Avondale School District | 7.4% | 2.7% | 5.8% | 3.8% | 1.7% | 4.3% |
| Berkley School District | 4.2% | 3.6% | 5.0% | 4.0% | 3.1% | 4.0% |
| Birmingham Public Schools | 20.6% | 18.9% | 17.7% | 17.4% | 18.1% | 18.5% |
| Bloomfield Hills School District | 27.5% | 28.5% | 27.1% | 28.4% | 29.0% | 28.1% |
| Brandon School District | 13.8% | 13.6% | 14.4% | 15.3% | 15.7% | 14.6% |
| Clarenceville School District | 14.0% | 14.2% | 16.1% | 18.8% | 16.5% | 15.9% |
| Clarkston Community School District | 10.3% | 18.9% | 23.4% | 25.3% | 23.7% | 20.3% |
| Clawson City School District | 13.9% | 8.1% | 8.2% | 5.5% | 5.5% | 8.2% |
| Farmington Public School District | 20.8% | 27.9% | 27.9% | 24.6% | 21.3% | 24.5% |
| Ferndale Public Schools | 2.2% | 1.5% | 1.3% | 3.5% | 5.0% | 2.7% |
| Hazel Park School District | 6.6% | 5.9% | 5.5% | 0.5% | 0.2% | 3.7% |
| Holly Area School District | 12.5% | 13.6% | 14.5% | 12.0% | 9.1% | 12.3% |
| Huron Valley Schools | 21.9% | 23.3% | 21.9% | 17.8% | 15.4% | 20.1% |
| Lake Orion Community Schools | 11.2% | 10.9% | 14.9% | 17.8% | 18.1% | 14.6% |
| Lamphere Public Schools | 17.0% | 15.5% | 15.2% | 15.1% | 16.0% | 15.8% |
| Madison Public Schools | -6.0% | -7.9% | -13.2% | -16.9% | -19.0% | -12.6% |
| Novi Community Schools | 15.8% | 17.4% | 19.4% | 19.4% | 16.9% | 17.8% |
| Oak Park School District | 21.3% | 19.1% | 17.1% | 8.3% | -4.7% | 12.2% |
| Oxford Area School District | 11.7% | 12.8% | 14.9% | 10.5% | 5.9% | 11.1% |
| Pontiac School District | 12.4% | 11.0% | 9.6% | 1.3% | 6.9% | 8.2% |
| Rochester Community School District | 8.2% | 10.2% | 17.8% | 23.2% | 22.8% | 16.4% |
| Royal Oak School District | 22.7% | 19.8% | 26.1% | 27.4% | 23.9% | 24.0% |
| South Lyon Community Schools | 6.4% | 7.3% | 7.0% | 6.8% | 7.0% | 6.9% |
| Southfield Public Schools | 17.2% | 18.8% | 20.9% | 17.9% | 13.6% | 17.7% |
| Troy School District | 35.3% | 29.8% | 33.4% | 23.5% | 22.8% | 29.0% |
| Walled Lake School District | 17.4% | 14.6% | 15.5% | 16.1% | 12.5% | 15.2% |
| Waterford School District | 9.1% | 8.8% | 8.6% | 7.5% | 6.0% | 8.0% |
| West Bloomfield School District | 10.2% | 8.6% | 11.6% | 11.2% | 7.8% | 9.9% |

The following narratives outline key details from each case study that provide information essential for understanding each district's reactions to the level of budgetary stress experienced. The narratives will help us understand what factors were influential in each district's decision-making process. We will also see how each district responded to new pressures as the economic downturn continued over a number of years. As outlined in the "Research Design and Methodology" section, the data gathered to tell the story of each school district in the study came from several sources. The most insightful and informative data came primarily from the finance managers in each school district. These individuals provided the most detailed and rich data to help explain how their district reacted to budgetary stress.

Clarkston Community Schools

Clarkston is a school district that has enjoyed a strong financial position despite the tough economic times. At the end of the 2005-2006 school year, Clarkston had 23.7% fund equity balance and has an average fund equity balance of 20.3%. Clarkston has approximately 7,900 students and serves a community that is located on the northern end of Oakland County and was chosen as an interview candidate because of the strong financial position the district enjoys. Clarkston Community Schools' fund equity increased from 10% in 2002 to 24% in 2006. As urban sprawl progressed, demographic shifts occurred, shifting the population from the core of Detroit outward. This northern area of Oakland County has experienced population growth as a result of the urban sprawl. The development in this school community is diverse. It includes a quaint downtown area, shopping centers, modern affluent subdivisions and open farmland.

While the downtown has been established for some time, much of the development is rather new. Once made up of a great deal of underdeveloped land, this community has experienced a substantial amount of residential and commercial growth. It can probably best be described as a middle-to-upper-income suburban area that has experienced growth with moderate-to-upscale development. Clarkston currently has one high school, one middle school, one upper elementary school, and seven elementary schools.

Revenue Enhancements

Clarkston does not participate in the Schools of Choice program at any level. Therefore, the large fund equity level cannot be attributed to non-resident population growth. One of the factors that contributed to the district not participating in Schools of Choice was the superintendent's desire not to participate. The leadership of the district feared that large populations of special education students would flock to the district through the Schools of Choice program because of the district's excellent special education programs. Students with disabilities are extremely expensive to educate compared to the general education population. For this reason, districts typically lose money educating a special education student. Once a district becomes a School of Choice district, they are prevented from denying any student an education in the district based on their educational needs provided the student lives within Oakland County. The idea of Schools of Choice is to generate additional revenue for the district, not cost the district additional expenditures.

Another factor contributing to the decision not to participate in the Schools of Choice program is Clarkston's close proximity to Pontiac School District. The southeastern tip of Clarkston Community Schools borders the northwestern tip of Pontiac

School District. Pontiac has a many low-achieving and minority students. Clarkston officials anticipated that large numbers of these students would enroll in Clarkston Community Schools, if the district participated in Schools of Choice. This would change the district's student composition such that it would not be representative of the community. Furthermore, there were fears that these low-achieving students would lower test scores. In an environment of the No Child Left Behind Act, test scores have become high stakes business, contributing significantly to a district's ability to make adequate yearly progress.

As an additional revenue enhancement, Clarkston has allowed private parties to advertise on school property. Most of this advertising occurs on the athletic fields, with signs posted on the baseball and football fields. The local hospital has placed an advertisement on the scoreboard. This type of revenue enhancement is governed by a board policy, which allows only ten percent of the sign to be covered with advertising. This revenue enhancement generates a small revenue stream to the district, with the hospital advertising being the largest revenue producer at \$45,000. This type of advertising began roughly five years ago in an attempt to generate revenue for the district. Some declines in advertising revenue have occurred over the years due to the beverage association standards restricting sales of certain unhealthy beverages to students. The factors that were most responsible for the district's decision to accept private advertising was the district business office pursuing advertising opportunities for the district.

Clarkston Community Schools charges students to participate in sports and activities as a means of revenue generation. The fee is based on an annual rate of \$200 at

the junior high level and \$225 at the high school level. Additional revenue enhancements include renting of facilities, which generates approximately \$200,000 a year and operating a “Young 5’s” program which allows the district to count the student for fourteen years of education provided the student has attained the age of five prior to the December first State imposed deadline. Clarkston Community Schools also had a unique opportunity to lease the high school to a movie production crew for \$10,000. One of the incentives to stimulate the economy in Michigan was tax credit given to movie producers for creating movies in the State. This initiative has brought many requests to school districts for use of their property in movie productions.

Expenditure Reductions

Clarkston Community Schools is one of the few districts in Oakland County that has not privatized any non-instructional services. There is a cost savings to utilizing a private company to deliver these services because the district is not obligated to pay retirement costs on the wages paid to private companies. This is a way to reduce the budget without cutting instructional areas. These types of reductions have been referred to as “low hanging fruit” because of how easy they are to attain.

Because Clarkston Community Schools enjoys a strong financial position, they have not had to negotiate wage concessions or freezes from any employee groups or require that the employee groups pay a portion of the health insurance premium. To keep benefit costs low, the district does not offer any Michigan Education Association sponsored benefits to their employee groups, namely MESSA insurance. This is significant because the costs of these products are typically higher than other comparable products in the benefit market. To further reduce benefit expenditures, the district is self-

funded for dental and vision, and the district pays the employees deductibles of \$1,250 for a single person and \$2,500 for a couple for these benefits.

To help reduce instructional expenditures, the district has increased the class size. The class size maximums are addressed in the union contract and are fairly small increases implemented by grade level. The district has also made some programmatic changes in special education and delayed textbook adoptions in an effort to assist the district with their financial goals. Further reductions have come through the reducing of department chairs, eliminating administrative performance incentives, reduced travel and reduced capital needs. Supply budgets have also been reduced by means of allocating a smaller supply amount on a per pupil basis. The district does not participate in any consolidation of services, but would be willing to entertain any efforts to consolidate services with other districts.

Summary

Clarkston Community Schools is one of the districts that do not conform to the expected outcomes of the research. The district enjoys a high level of fund equity despite the fact that they do not participate in schools of choice at any level, or have privatized any of their non-instructional services and has not made wage concessions or freezes or required employees to pay a portion of the health insurance premiums. Clarkston appears to be able to operate on the revenue that is provided without taking drastic measures to maintain the strong financial position that they currently enjoy. Based on a review of the behaviors and the level of fund equity percentage, it appears that Clarkson Community Schools has a low level of fiscal stress and is not experiencing a great deal of pressure to improve the fund equity percentage.

Royal Oak School District

Royal Oak School District in the southeast corner of Oakland County has approximately 5,000 students. Royal Oak has been experiencing declining enrollment over a number of years and has had to close instructional buildings in response to this decline. Nevertheless, Royal Oak has enjoyed a strong financial position with fund equity at 23.9% at the end of the 2005-2006 school year. Of the five years span being analyzed in this research, Royal Oak has experienced an average of 24% fund equity levels. Royal Oak is an older suburban district mostly developed shortly after World War II, with not much vacant land available for new construction. It has a mixed racial/ethnic population and has minority populations close by. This city is basically a small bedroom community with its major landmark being Beaumont Hospital. Royal Oak has one high school, one middle school and six elementary schools.

Revenue Enhancements

Since 1997, Royal Oak School District has participated in limited Schools of Choice on a space available basis. In the beginning, the district piloted the program in one building and went on to further expand the program. Enrollment increased dramatically, but so did the perceived student behavior problems. Therefore the program was adjusted to limit the enrollment to students only in grades kindergarten through third and only through section 105 of the school code, which allows only students in Oakland County to enroll. This limited Schools of Choice enrollment adds less than one hundred students to the student population. The district has never participated in Schools of Choice through section 105c of the school code, which would allow students from outside the county to enroll in the Royal Oak School District. The reason that Royal Oak

School District does not participate in 105c Schools of Choice is because of their close proximity to Detroit. Detroit Public Schools has a large majority of minority students with significantly lower average achievement levels than Royal Oak. The concern is that large numbers of Detroit Public School students would enroll in Royal Oak School District changing the student population so that it would not be representative of the community that Royal Oak School District serves. Additional concerns of reduced test scores would impair the district's ability to make adequate yearly progress in the high stakes testing environment that public schools are currently operating in. This district would seem attractive to families from perceived failing school systems nearby.

As Royal Oak School District has closed instructional buildings, the number of Schools of Choice seats available has declined because there is less space available and the district is obligated to educate the resident students first before it looks outside of the district for additional students to fill empty seats. The district believes that participating in the Schools of Choice program has been financially beneficial but continues to limit the enrollment so that the student population can be controlled. The factor that contributed to the decision to participate in Schools of Choice was an internal factor, coming from a desire expressed by the Superintendent. The Superintendent of Royal Oak was concerned about maintaining fund equity levels and also saw that other districts in the area were participating in the Schools of Choice initiative so he introduced the concept to the school board as a way to enhance revenue and maintain fund equity levels.

Regarding other revenue enhancement opportunities, Royal Oak School District does advertise on school district property. Royal Oak School District allows the local bank to advertise on the football field scoreboard for a one-time fee of \$30,000. The

advertising was placed on the scoreboard for a period of three years and was in compliance with the district policy regarding how much of the face of the scoreboard could be covered by the advertisement. The district also sells advertising in publications that are distributed through the school and community and also generates some additional revenue by renting out district facilities to outside groups. The district believes that the advertising has been somewhat successful with generating additional revenue, though not a large amount of revenue has been generated. The factors that were responsible for the district's decision to advertise were internal, with the Executive Director of Business and Personnel Services promoting and securing the advertising.

Royal Oak School District does not charge for students to participate in sports, except for ice hockey and lacrosse, which are self-supporting sports. The reason for this is that both of these sports are expensive to operate. All of the other sports are provided to the students free of charge. The district also generates some additional revenue from a beverage consortium that is operated within the school district.

Expenditure Reductions

Royal Oak School District has privatized its food service program but no other non-instructional services. The food service area is a place that a district would privatize with the least impact on district employees. The reason for this is that food service employees only work a few hours a day, making it almost impossible to fully vest in the Michigan Public School Employee Retirement System. Furthermore, food service employees are typically not entitled to health benefits through the district because of their lack of full time employment status. Royal Oak School District also out-sources an occasional bus run in the event that the in house transportation department is not

available to accommodate the demand. Substitute teachers are also contracted through a privatized company thereby eliminating the district's contribution to the Michigan School Employees Retirement System, which is approximately sixteen percent of the gross pay of each employee.

Royal Oak School District has never negotiated a pay freeze or a wage concession because the district is not in dire financial straits. However, the district has increased the insurance deductible an employee is obligated to pay and has also changed insurance plans that the district offers their employees in an attempt to reduce expenditures.

In an effort to reduce expenditures, class size in the all day kindergarten program has increased. There is contract language in the Royal Oak School District that speaks to class sizes and sets forth a maximum class size that a teacher is contractually obligated to instruct. The class sizes addressed in the teacher's contract have not increased.

Royal Oak School District has reacted to budgetary stress by actually increasing class offering to make the district more attractive to incoming families and to students who may have chosen private schools within the district boundaries or to students who have left the district to attend other neighboring schools through the Schools of Choice program. In a pro-active effort to retain its existing student population and possibly recruit some students back into the district, the district has expanded the kindergarten program to all day long, instead of just half days and has also added foreign language instruction at the elementary level.

Royal Oak School District has reduced the number of district and building level administrators through attrition and through closing buildings. As buildings have been closed, the district eliminated the building level administrator because the position was

no longer necessary. Furthermore, as district administrators that were located in the administration building retired, their positions were not re-staffed. An example of this is when the Human Resources Director retired, the duties were split between the Executive Director of Business and Technology Services and the Executive Director of Business and Personnel Services. Furthermore, the Executive Director of Vocational Education and the data processing positions were eliminated through attrition and a reassignment of responsibilities.

Royal Oak School District has engaged in consolidation of services, but not with other local school districts. Instead, the district has partnered with the City of Royal Oak to barter services that would otherwise have been an expense for each entity. For example, the City of Royal Oak picks up the districts garbage for free in exchange for free use of the districts facilities.

Summary

Royal Oak School District has a high fund equity percentage, averaging 24% over the five years of this study. They have participated in the typical revenue enhancements measures such as participating in the schools of choice program, advertising on district property and generating revenue through alternative means, particularly selling property to Beaumont Hospital. The only revenue enhancement measure that Royal Oak does not participate in is charge students to participate in athletics or activities. Royal Oak has also implemented a variety of expenditure reduction measure in an effort to retain fund equity, such as privatizing non-instructional staff, require employees to pay a portion of the health insurance premium, eliminating administration through attrition and implementing creative ways to consolidate services with the City of Royal Oak. Royal

Oak School District has also maintained a pro-active position to attract and retain students by not eliminating programs and services or increasing class size, but instead expanding course offerings and maintaining class size. From a review of the behaviors and the fund equity percentage, it does not appear that Royal Oak School District is experiencing a high level of fiscal stress or pressure to respond to fiscal stress.

Avondale School District

Avondale School District is a district of approximately 3,800 students and is located in the center of Oakland County but close to the eastern border of the county. The student population in the Avondale School District has remained fairly stable, despite the fact that the community that Avondale serves is highly dependent on the suffering automotive industry with the headquarters of the Chrysler Corporation right in its backyard. Avondale School District was chosen to interview because of their fairly weak financial position. Over the five-year span of this study, Avondale has been experiencing a fairly slow decline in the percentage of fund equity from seven percent in 2002 to two percent in 2006. Avondale was chosen as an interview candidate because of this low fund equity percentage. Avondale currently has one high school, one middle school, one upper elementary school, three elementary schools and one lower elementary school.

Revenue Enhancements

Avondale School District has chosen to participate in the Schools of Choice program throughout the schools years 2002-2006 under section 105 of the Michigan School Code. However, the district participates in a very limited basis, with only 20 seats

available and only in grades kindergarten through second. Therefore, almost all of the students that are attending Avondale School District are resident students. The factors that were responsible for the district's decision to participate in the Schools of Choice program on such a limited basis were internal, mostly coming from the direction of the Superintendent. Avondale School District's entire northeast region is bordered by Pontiac School District. There was great concern that opening the district to Schools of Choice in large numbers would generate a large influx of Pontiac School District students who are typically minority, low-achieving students from a low socio-economic background. The students that attend Avondale are predominantly fairly high achieving students from middle class backgrounds. It was thought that opening the district to Schools of Choice would change the district population and achievement dramatically, which would impact test scores and impede the district's ability to attain adequate yearly progress.

Avondale School District does not allow private parties to advertise on school district property, however Avondale School District does charge their students to participate in athletics. The fee is one hundred and thirty five dollars a year and is not contingent upon the number of sports or activities a student may participate in and there is not a maximum limit that families pay.

Additional revenue enhancements that Avondale School District has embarked on are increased lunch prices of twenty cents across the entire district. Avondale School District also has a latchkey program, where parents can place their children for before and after school care, which generates additional revenue for the district. Avondale

School District also participates in vending machine consortiums with Coca-Cola and the district receives vending revenue from this arrangement.

Expenditure Reductions

Avondale School District privatizes all of its non-instructional services except transportation. The non-instructional services that are privatized include custodial services incorporating the cleaning and minor repairs of the buildings. Grounds services are also privatized, which include snow removal, landscaping and grass cutting. Food services, which is the preparation and serving of breakfast and lunches to the student population are also privatized. Maintenance of the buildings, which include electrical and plumbing repairs, which typically are performed by a skilled labor force are also privatized.

Avondale School District has negotiated pay freezes for all of the district's administrators, however no concessions have ever been negotiated. Furthermore, the district offers MESSA health insurance, which is an insurance product backed by the Michigan Educational Association and no changes or reductions in benefit offerings have been negotiated. However, administrators are required to pay five percent towards the cost of their health insurance, but during negotiations the district was able to compensate these individuals by four hundred dollars in other areas of the contract, which according to the Chief Financial Officer had no impact on the employee's net compensation.

As far as reductions in expenditures that would impact the classroom, Avondale School District negotiated an increase in class size in the teacher's employment contract by two students per class. This increase has not resulted in the reduction of any teachers. Avondale School District has not reduced any programs or services since the economic

downturn. The reason was because the district would like to continue to remain competitive with neighboring school districts.

Avondale School District has eliminated an assistant principal at the upper elementary building due to the decrease in student enrollment. The athletic director's position has been combined with the assistant principal's position at the high school and the assistant principal has been contracted, upon retirement, to be the human resources coordinator. Avondale School District shares a technology person with the neighboring school district, Rochester Community Schools. All of these position consolidations, eliminations and service consolidations have resulted in cost savings to the district.

Summary

Avondale School District is a district that is teetering on the brink of plunging into a deficit fund equity position. At the end of the 2005-2006 school year, Avondale School District was maintaining a 1.7% fund equity level. The revenue enhancement and expenditure reduction measure that were implemented are behaviors that are clearly a result of an effort to maintain, if not improve the fund equity position. Avondale participates in the schools of choice program, though not extensively. They charge students to participate in athletics or activities and have generated revenue through other sources, however they do not advertise on district property. Avondale has privatized almost all of the non-instructional staff except transportation, has required employees to pay a portion of the health insurance premium, negotiated pay freezes but not wage concessions, increased class size, eliminated administrative positions and building principals and has consolidated services with other school districts. The only expenditure reduction measures that have not been implemented are reducing employee benefit

offerings and the elimination of programs. From a review of the behaviors, it appears that Avondale is feeling pressure to implement as many measures as possible to steer clear of a deficit financial position.

Berkley School District

Berkley School District has approximately 4,200 students and is located on the southeast border of Oakland County. Berkley School District has one high school, one middle school, and five elementary schools. This district was chosen to interview because of the weak financial position that the district has been in. The fund equity percentage of Berkley School District has varied between three and five percent in the five years included in the span of this study. At the end of the 2005-2006 school year Berkley was maintaining a Berkley a 3.1% fund equity percentage. Berkley School District is also considered an urban school district, with not a lot of vacant land to develop for new housing starts. Berkley is also one of the few school districts in the state that does not provide transportation for any students other than special education students. Berkley contracts for these limited transportation service because it is required by the State of Michigan. Because of this reason, Berkley is reluctant to close any of the elementary school buildings because they have sold themselves as a “neighborhood school” which means that every neighborhood is within walking distance to an elementary school building.

Revenue Enhancements

Since 2001, Berkley School District has been participating in the schools of choice initiative. The district participates in the 105 section of the school code, which

allows for students residing in the county to enroll in Berkley, but does not participate in the 105c section of the school code, which would allow students residing outside of Oakland County to enroll in the Berkley School District. During the first years of participation, the district had unlimited enrollment in an effort to increase enrollment. The participation in the Schools of Choice program changed the population of the school district as the district began to be removed from the neighborhood school image that the community wanted. Schools of Choice students now make up about nineteen percent of the overall student population in the Berkley School District. Because of the perceived unwanted changes that Schools of Choice brought to the district, enrollment through Schools of Choice began to be limited to concentrate on kindergarten through second grade, with Schools of Choice seats available on from kindergarten through fifth grade. The Deputy Superintendent of Finance and Human Resources believes the program has been very successful at generating revenue for the school district. The factors that were responsible for the original decision to participate in Schools of Choice came from the internal administration and the school board was involved from the beginning of the process. The factors that contributed to the reduction in the participation of the schools of choice program came mainly from external stakeholders, namely the community not pleased with the students that were attracted through the program and the current board president was not a big supporter of the program.

Berkley School District has allowed the local grocery store to advertise on the scoreboard at the high school for a one-time fee of \$15,000. The district also has a policy that would allow anyone interested in purchasing the naming rights to various district facilities or rooms. The factors that were responsible for both of these additional revenue

enhancements were the athletic director promoting the scoreboard advertising and the Deputy Superintendent of Finance and Human Resources promoting the policy that paved the way for additional advertising revenue if the situation presents itself.

Berkley School District charges students \$65 per sport at the high school to participate in athletics, with a maximum of \$130 per student. The middle school students are charged \$40 per sport, with a maximum of \$80 per student. There is also a \$215 family cap on pay to participate fees. The pay to participate has generated a small amount of revenue to off set the cost of athletic offerings.

Berkley School District has also been very creative in maximize other revenue enhancement opportunities. The football stadium has artificial turf and a stadium manager was hired to handle stadium rentals, which also covers the cost of this position and generates additional revenue for the district. The district sells fitness center public memberships to the district athletic facilities, operates an alternative education program for students that are eighteen to twenty one years of age without a GED, and has sold an unused building to a willing buyer for one million dollars. Furthermore, the district has partnered with Southfield Public Schools for a day care program in an effort to consolidate services. Berkley School District also allows some private school students to take non-core classes and in return, Berkley receives the enrollment count for state aid reimbursement.

Expenditure Reductions

As previously mentioned, Berkley School District is fairly unique compared to other local school districts in that they don't operate a transportation system. The district likes to promote itself as a neighborhood school district, thereby having an elementary

school within walk-able distance to every neighborhood. The middle school and high school are centrally located and easily accessible to students in the district. This leaves the transportation of special education students, which is mandatory that the district provides. Berkley School District privatizes the transportation of these students as well as the food service non-instructional areas as well. The other area that Berkley School District privatizes is the substitute teachers and the substitute support staff and coaches.

Berkley School District has never negotiated wages concessions or freezes, but everyone except paraprofessionals contribute financially in some way to the payment of the health insurance premium. The benefit offerings have been reduced from a more expensive plan to a less expensive plan but still remained inside the MESSA group of health insurance offerings.

Berkley school district has neither increased class sizes or decreased or eliminated any programs. The reason for this is that Berkley School District wanted to remain competitive and attractive to potential families compared to other neighboring districts. The district has reduced the number of administrative staff by one at the central office level and has eliminated two positions at the cabinet level by reassigning duties to the five remaining cabinet members. Berkley School District has been fairly creative with other expenditure reductions. Some of those reductions have been to eliminate overtime costs for custodial and maintenance, eliminate two secretarial positions, reduce the para-educators hours so they are no longer eligible to receive health benefits, and continue to downsize the teaching staff as enrollment declined. As previously mentioned, Berkley School District also participates in several consolidation of services opportunities with Southfield schools including a technical career center.

Summary

Berkley School District is also a school districts that is experiencing severe financial stress. At the end of the 2005-2006 school year, Berkley School District was maintaining a 3.4% fund equity level. The revenue enhancement and expenditure reduction measure that were implemented are behaviors that are clearly a result of an effort to maintain, if not improve the fund equity position. Berkley participates in the schools of choice program, though not extensively. They charge students to participate in athletics or activities and have generated revenue through other sources and charge for advertising on district property. Berkley has also generated revenue through other alternate sources. Berkley has privatized almost all of the non-instructional staff except custodial and maintenance, but has not required employees to pay a portion of the health insurance premium or negotiated pay freezes but not wage concessions. They have eliminated administrative positions and consolidated services with other school districts. They too have maintained a pro-active position to attracting and retaining students by not increasing class sizes or eliminating programs. From a review of the behaviors, it appears that Berkley is feeling pressure to implement as many measures as deemed feasible to steer clear of a deficit financial position.

Madison Public Schools

Madison Public Schools has approximately 1,600 students and is located in the southeast corner of Oakland County. Madison Public Schools has been a concern for the Michigan Department of Education for a number of years due to the districts on going

negative fund balance. During the five-year span of this study, the fund equity percentage of Madison Public Schools has decreased dramatically from a negative six percent to a negative nineteen percent. At the end of the 2005-2006 school year, Madison Public Schools had a –19% fund equity level. Madison Public Schools' ongoing negative fund equity is the reason this district was chosen as an interview candidate. Once a school district has a negative fund balance, the district is obligated to file a deficit elimination plan with the Michigan Department of Education, which outlines a plan to restore fiscal health to the district.

Revenue Enhancements

Madison Public Schools participates in the Schools of Choice program through the 105 section of the school code as well as the 105c section of the school code. This means that students residing within Oakland County and students residing in contiguous counties can enroll in Madison Public Schools. The district began participating in Schools of Choice during the 2005 school year and has made unlimited seats available to incoming students. The Schools of Choice program has been fairly successful at generating revenue for the district and slowing the continual decline of enrollment but has not done much to increase enrollment. The factors that were responsible for the decision to participate in the School of Choice program were the internal and external pressures on the district administration to balance the district budget.

Madison Public Schools does not sell access to private parties to advertise on school district property, nor does the district charge students to participate in sports. The district does generate some additional revenue from leasing space for a cell tower to a

cell phone company, but outside of this cell tower arrangement there are no other revenue enhancements opportunities being maximized.

Expenditure Reductions

Madison Public Schools has not privatized any non-instructional services except for the grounds maintenance in the summer, particularly lawn mowing. Non-instructional services include transportation of students, food services, custodial and maintenance of buildings and grounds maintenance.

Madison Public Schools has negotiated wages freezes with several employee groups, but no concessions have been negotiated. The principals, the teachers, and the para-educators have all received a negotiated pay freeze. The length of the freeze is for two years until the contract is renegotiated. Employee benefits have also been nominally affected by reducing the number of banked sick days that were allowed from one hundred and seventy days to one hundred and twenty five. This only results in a cost savings to the district when an employee happens to retire. Insurance caps were also negotiated so that if the insurance increases over a certain amount, the employees are obligated to pay the increase. Again, this cost savings is only realized if the insurance is increased over the percentage negotiated. Consistently over the past several years, increases in health insurance costs have been nominal.

Madison Public Schools has not increased their class size or eliminated any programs or services. The district has, however, eliminated one central office administrator in response to budgetary stress. The district has so few buildings that eliminating principal positions is not an option. Furthermore, the district has

consolidated services with nearby Clawson Schools by consolidating transportation services with that district.

Summary

Despite the obvious extreme ongoing fiscal distress, it does not appear that Madison Public Schools are implementing very many revenue enhancement or expenditure reduction measures. Of the four revenue enhancement measures, Madison chose to implement only two, participating in schools of choice and generating revenue from alternative sources. They do not charge students to participate in athletics or activities and do not advertise on district property. Part of the decision to not charge students could have to do with the socio-economic backgrounds of the students the district serves. On the expenditure side, it appears that much more could be done to improve the financial health of the school district. Madison only privatizes summer grounds work, does not require employees to pay a portion of their health insurance nor has the benefit offerings been reduced. They have not negotiated a significant wage freeze and no wage concessions have been negotiated. Furthermore, class sizes have not increased and programs and services have not been reduced. Administration has been eliminated through attrition only, however the district is participating in consolidation of transportation services. It appears that Madison Public Schools does not feel pressure to respond to fiscal distress due to the low level of implementation of revenue enhancing and expenditure reduction measures.

Oak Park School District

Oak Park School District is located in the southeast corner of Oakland County and has approximately 4,400 students. The district has one high school, one middle school, one upper elementary school and three elementary schools. The district has had a declining fund balance for the five-year span of this study, starting with a very strong fund equity percentage of 21% and ending the 2006 school year with a negative 5% fund equity. The rapid decline in fund equity and the subsequent negative fund equity is the reason this district was chosen for an interview. The district demographics are predominantly minority (in the upper 98%) though the community has a large Jewish population. The Jewish students attend private Jewish schools inside the city of Oak Park. Therefore, the population of the school district is not representative of the community as a whole.

Revenue Enhancements

Oak Park School District participates in Schools of Choice 105 and has since the inception of the Schools of Choice program in the late 1990's. As of the 2005-06 school year, the district began to participate in 105c Schools of Choice as well, on an unlimited basis, which means that students from inside Oakland County and from counties that are contiguous to Oakland County and enroll in Oak Park Schools. The Schools of Choice program has been very successful, particularly the 105c initiative, with enrollment increasing from 3,400 students to over 4,400 students in just the three years the district has been participating in the 105c program. The district was able to end the 2007 school year, which is outside of the scope of this study, with a positive 2% fund equity. Therefore, the Schools of Choice program has been largely successful restoring financial

health to the district. The main factor that contributed to the participation of the School of Choice program is that in 2005 a new administration was hired at the Oak Park School District with the charge of turning the district finances around. The Superintendent was the key influencer, persuading the school board at the time that participation in the Schools of Choice program would benefit Oak Park Schools.

Oak Park Schools does not allow private parties to advertise on school district property, nor do they charge their students a fee to participate in sports. Other revenue enhancements that the district has undertaken, was to increase lunch prices by a nominal amount to make the cafeteria operations self sufficient, and rent out the district facilities to interested parties in the community to generate additional revenue for the district. The district also earns revenue from the vending machines that are operated by a private vendor.

Expenditure Reductions

Oak Park School District has not privatized any non-instructional services, except food services and some special education transportation. The district is reluctant to privatize because many of the staff members that provide non-instructional services to the school district also reside in the school district and recently voted for a new bond issue for building renovations. The administration would like to if the district can be restored to financial health through growth in the Schools of Choice program before drastic budget reductions such as privatizing are implemented.

Oak Park School District employees have not taken a wage freeze or concession, however the benefit offerings have been reduced. All district employees have been transferred to a less costly package but still within the MESSA insurance offerings.

Furthermore, the co-pay on prescriptions have been increased from \$2 for generic brand prescriptions to \$10 and from \$5 for name brand to \$20 for name brand prescriptions. This resulted in a \$500,000 cost savings to the district. District employees are not required to pay a portion of their health insurance benefits.

The average class size has increased at all levels within the school district, particularly because at the start of the economic downturn the class sizes were too small. No programs or services have been eliminated at Oak Park School District. In fact offerings have been expanded to incorporate foreign languages at the elementary level and dual enrollment and vocational educational opportunities at the high school. The reason for the expansion of programs is an attempt to retain resident families, who are sending their children to neighboring school districts, and attract students to Oak Park School District through the Schools of Choice program.

Oak Park School District has not eliminated the number of building level administrators because of the increase in enrollment. However, even though the enrollment has increased by 1,000 students in three years, no additional building level administrative staff has been added. The district does not participate in consolidation of services initiatives with other school districts but would be willing to consider all opportunities to reduce expenditures.

Summary

At the end of the 2005-2006 school year, Oak Park had a deficit fund equity position, with fund equity at -4.7%. Despite the obvious fiscal distress, Oak Park did not pursue a variety of revenue enhancement or expenditure reductions measures, but rather chose to focus on increasing the schools of choice enrollment through 105c, rather than

reduce expenditures or seek alternative revenue generation sources. Oak Park did not allow advertising on district property, nor did they charge students to participate in athletics or activities, largely due to the low socio-economic background of the students they serve. However, they did generate revenue through alternative sources. Oak Park participates in privatization on a limited basis, only privatizing food services and a small component of transportation. They have not required employees to take a wage concession or a wage freeze, or pay a portion of their health insurance premiums. They have however, negotiated a reduction in the benefits by increasing the co-pays on the prescription drug insurance. Oak Park Schools has also taking a pro-active position to attract and retain students by expanding programs and services. As a result of the growth the district has experienced, they were not able to eliminate administrative or building principal positions, and only participate in consolidation of services to the level of special education transportation that is a countywide initiative. It appears that Oak Park Schools does feel some pressure to respond to fiscal distress and has implemented an aggressive marketing campaign to increase the schools of choice revenue rather than reducing expenditures to improve financial health.

CHAPTER VI

FURTHER ANALYSIS OF FINDINGS

The variety of revenue enhancement and expenditure reductions measures that were implemented in the research setting elicited both predictable and unpredictable results from what one would expect. Clearly the unique circumstances of each district studied affected the results. Generally speaking, the research has proven that districts that are able to contain their administrative costs and have a low average teacher's salary experience lower levels of fiscal stress. These districts also require employees to pay a portion of the health insurance premiums, have eliminated programs or services that are either costly to the district or have low participation rates, and have increased class size and therefore have higher fund equity levels than the districts that don't exhibit these behaviors. These successful districts also participate in advertising on district property, charge students to participate in athletics and activities and find other means to generate revenue.

Contrary to what one would expect, the districts that participate in the schools of choice program, have privatized non-instructional services, have frozen wages, reduced benefits, eliminated principals and consolidated services in some form have lower fund equity levels than the districts that have opted not to implement these revenue enhancement and expenditure reduction measure. The two measures that districts chose to implement most, participating in schools of choice and privatizing non-instructional services, have proven to be behaviors of districts with low fund equity balances. Perhaps a reasonable explanation could be the net affect of the schools of choice program. There

are only so many school age children in the State of Michigan. If a student enters a school district through schools of choice, they are also exiting another district. Furthermore, what was the cost savings associated with the privatization of non-instructional services and what would fund equity levels be if these services were not privatized? There appears to be somewhat of a mismatch between some of the measures implemented and the outcomes of those measures. It appears that some measures produce a reverse causation. Though no strong patterns have appeared, each measure implemented that has resulted in an unpredictable outcome doesn't mean that the implementation didn't improve the fund equity level to some degree. Some districts only embrace large changes, such as privatization when they are in a deficit.

The one revenue enhancement option that would have the largest impact on district revenues is the schools of choice program. The current economic environment would lead us to the conclusion that this would be a key factor that would influence school districts in their decision to opt in to the state choice program. More and more districts are beginning to feel significant financial pressure and have run out of expenditure reductions options and are looking for additional revenues through accepting nonresident students.

The decision to accept schools of choice students is often not an easy one for districts to make. A significant factor in choosing this option is the racial and socioeconomic makeup of surrounding school systems. Earlier studies have identified that students typically opt for choice schools in the more affluent communities. Thus, if school systems are near lower socioeconomic communities, they will face the consideration of having lower socioeconomic students come to their schools and the

impact that may have on their community in terms of the perception and the desirability of their schools. We know that the perception of the school districts is often measured by socioeconomic-influenced factors such as racial makeup, income, and student test scores. A change in the perception of the schools could drive out current resident students. Thus, school districts may risk the loss of revenues when current resident students themselves participate in the schools of choice program and choose to move to more desirable neighboring districts as the conditions and environment inside their resident schools decline as a result of the changes in the socio-economic background of the student body. The fear of a decline in the socio-economic status and racial makeup of the student body and lower test scores was exactly the reasoning cited by several of the districts that participated in interviews for choosing to opt out of the schools of choice program. Two of those school districts were in close proximity to Pontiac public schools, which serves a low socio-economic population.

Lastly, local dynamics of each community, influenced by key players such as the superintendent, board members, special interest groups, and influential community leaders, also can impact school district decisions. It is assumed that financial condition would bring about the most pressure on a school district to opt in to the school choice program. Other considerations could be the makeup of the surrounding districts and the local dynamics. Schools are more willing to market themselves to the surrounding districts if those districts have the same socio-economic makeup as their own. Unique dynamics exist when combining economic pressure and local political pressures.

Taking all of these dynamics into consideration, it is important to note that the districts that have been able to maintain large fund equity balances are the districts that

service communities with high socio-economic status. These wealthy districts typically do not participate in the schools of choice program and have effectively created borders for entry into the school system. Only residents of these districts are able to attend the local public schools, thereby guaranteeing the student body will mirror the socio-economic and racial makeup of the community. If market forces are beginning to be unleashed, why aren't all school systems reacting to them?

There is no doubt that some form of competition has been generated through choice initiatives. The districts most threatened by the loss of revenues tend to be the ones most likely to compete. It is also widely acknowledged that when students opt in to the schools of choice program, they are essentially escaping poor school systems that serve a low socio-economic community to move to a more wealthy school district that serves a higher socio-economic community. Such actions have resulted in a sorting of students and creating winners and losers within the school choice system. Therefore, wealthier districts that have chosen to participate in the schools of choice program continue to remain wealthy while poor districts continue to remain poor as more and more students opt to move out of the district. Furthermore, this market competition has created social harms such as segregation and sorting that will have an impact on student achievement. The most affected are those urban districts that service areas with little growth potential, such as Detroit.

More than just the choice initiative is threatening the financial success of some of the poorer school systems in the State of Michigan. The funding structure implemented under Proposal A is in dire need of a reconfiguration. Proposal A was implemented without consideration for any downturns in the economic climate. Now that districts are

unable to generate local revenue to operate their school systems, districts are experiencing fiscal stress because the financial condition of the State has proven to be one that is unable to support school systems with adequate revenue to operate. Furthermore, even when districts are able to pass local bond issues for such things as infrastructure improvements and technology, districts that have low property values are not able to generate as much property tax revenue as districts that are property rich. This disparity in the ability to generate local property tax revenue between poor districts and wealthy districts guarantees that students from low socio-economic environments will be educated in deteriorating school buildings that lack the necessities conducive to student success. The wealth of a district heading into Proposal A is a large indicator of how wealthy a school district is in this post-Proposal A era.

Furthermore, the non-homestead component of Proposal A provides for 18 mills to be levied on non-homestead property to be used for general operations of a school system. Districts that serve low socio-economic communities typically serve communities with low property values, including non-homestead property values. Therefore, the ability for a poorer district to generate property tax revenue to operate their school district is much less than the ability for a property wealthy district to generate operating revenue. This is essentially the major reason for the disparity in per-pupil funding from district to district.

When one considers the financial condition of school districts in the State of Michigan, many factors come into play, which makes the topic such a significant and widely debated one in educational and public circles. It is evident that further study is needed to determine the long-term affect on school districts of the revenue enhancement

and expenditure reduction measures implemented by the districts in the study. It is also evident that with this prolonged downturn in the economic climate, financial pressures are moving up the wealth chain with more and more districts implementing changes in the way they conduct business that wouldn't have been considered if it weren't for the pressures of fiscal stress. With no changes in the economic environment in sight, there can only be more financial pressure on Michigan school districts in the future.

EXHIBIT 1 FINANCE MANAGER SURVEY

Reaction to Budgetary Stress in Michigan Public Schools: A School Business Administrator's Perspective

School District Survey

| | |
|------------------------|--------------------------|
| <hr/> | <hr/> |
| School District | Name of Responder |

Which of the following steps has your school district taken to enhance revenues over the last five years?

- ☐ Participate in Schools of Choice
- ☐ Sell access to advertising on school property, on
 - ☐ Athletic fields or gymnasiums
 - ☐ Buses
 - ☐ Cafeterias
 - ☐ Hallways
 - ☐ Classrooms
 - ☐ Other _____
- ☐ Institute pay to participate in sports
If so, which sports _____
What is the fee _____
- ☐ Other revenue enhancement strategies undertaken in the last five years

Which of the following steps has your school district taken to reduce expenditures over the last five years?

- ☐ Privatize non-instructional services?
 - ☐ Transportation
 - ☐ Custodial
 - ☐ Food Service
 - ☐ Maintenance
 - ☐ Grounds

- ☐ Security
- ☐ Substitute Teachers
- ☐ Other _____

☐ Negotiate employee pay freezes or concessions

If so, with whom?

- ☐ Teachers
- ☐ Support Staff
- ☐ Administration
- ☐ Bus Drivers
- ☐ Custodians
- ☐

Other _____

☐ Increase employee payments for health insurance

☐ Reduce services covered by employee health insurance

☐ Increase class size
If so, which grades _____

☐ Eliminate or curtail instructional programs
If so, which ones _____

☐ Eliminate or curtail instructional support services
If so, which ones _____

☐ Reduce number of district administrators

☐ Reduce number of building-level administrators

☐ Consolidate service provision with other school districts.

EXHIBIT 2 INTERVIEW QUESTIONNAIRE

Interview Tool

For Six Select School Districts

Revenue Enhancements

In the past five years:

1. Has your school participated in Schools of Choice? If so, do they participate under 105? 105c?
2. Has your school advertised on school property? If so, where exactly?
3. Has there been a charge for students to participate in sports? If so, what is the fee and how many sports is the fee based on? Are there special arrangements for multiple sports athletes or families with multiple athletes?
4. Are there any other revenue enhancements that your district participates in that were not mentioned?

Expenditure Reductions

1. Has your school privatized any services, non-instructional or otherwise? If so, which ones?
2. Have there been negotiations of wage concessions or freezes? If a freeze has been enacted, how long was the freeze? If a concession was enacted, how much of a concession was negotiated?
3. Have there been negotiations of reductions in benefits or offerings? If so, what were the reductions or changes in benefits?
4. Has the district required employees to pay a portion of health insurance premiums? If so, how much are employees required to pay?

5. Has class sizes increased? If so, what was the increase?
6. Have any programs or services been eliminated? If so, what programs or services?
7. Has there been any consolidation of services with other districts? If so, what services?

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