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**School Finance: A Study of School Districts in Texas that Successfully Emerged  
from ‘Substandard’ Fiscal Ratings**

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**School Finance: A Study of School Districts in Texas that Successfully Emerged  
from 'Substandard' Fiscal Ratings**

by

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**Dissertation**

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**School Finance: A Study of School Districts in Texas that Successfully Emerged  
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Historically, the educational community has assumed that with the existing resources school districts could maintain their financial stability. Within the past decade, we have found that these expectations are not true, as many districts have found their resources insufficient to accomplish their objectives. Currently, there are no studies in Texas of school districts’ decision-making processes that have contributed to ‘substandard’ fiscal ratings from the Texas Education Agency. Nor have there been studies of school districts that have emerged from such ratings.

The purpose of this study was to describe the context within which financial decisions were made and the decision-making processes regarding resource allocation in two school districts in Texas. The focus was on identifying factors that have contributed to fiscal insolvency and those which have promoted fiscal solvency. This study was qualitative in nature in that it examined two cases of school districts that received ‘substandard’ fiscal ratings from the Texas Education Agency and subsequently emerged from those ratings. A quantitative application of four financial ratios was utilized to

ensure the selected schools met the criteria. The content analysis of interview data was supported by an analysis of primary documents such as board minutes and audits. The respondents that were interviewed included the current superintendent, business manager, and TEA representative of the districts.

The research focused on those contextual conditions, including changes in the law governing taxes and allocation of monies, and the fiscal decisions that have resulted in districts becoming fiscally insolvent and then regaining solvency. The theoretical framework of the research included budgetary decision-making models and their application to public school budgeting.

The research suggests that the financial problems in each district were severe, yet incremental. The contributing factors included a lack of financial leadership and knowledge as well poor communication based on inadequate budgetary decision-making models.

This research further develops scholarship in terms of fiscal recovery. Recommendations are made for school boards, superintendents and financial officers in individual school districts. The findings should allow education policy makers to understand and possibly preempt fiscal problems in their jurisdictions.

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## CHAPTER I

### Introduction

The American tradition that education is a state not a national function stems from the 10<sup>th</sup> amendment to the United States Constitution. Although it is not specifically mentioned in the document, the court system over the years has inferred that education is a national interest and a state responsibility. Perhaps this viewpoint is rooted in the American idea of rugged individualism, self-determination or, that all education is local. Yet, in any case, this notion of state responsibility for education has experienced an evolution in the basic structure of allocation and distribution of resources used to finance public schooling. In many states, this process for funding has gradually shifted from the broad shoulders of state generated revenues, to the over burdened backs of the local property owners.

The financing of schools has changed dramatically during the past 30 years. The largest component of change has been in per pupil expenditures in public elementary and secondary schools. This has been primarily as a result of expanded services provided by the schools. These services include more expensive specialized classes for high school students, compensatory education for students from disadvantaged backgrounds, special education and related services for students with disabilities, and desegregation efforts all contributed to increased costs. Also, efforts to improve funding equity and the political systems governing schools contribute to these increased expenditures. Furthermore, the additional money represents the coverage of higher costs for health and other insurance, pay for increased utility costs, and to raise salaries. Murray, Evans, and Schwab (1997)



suggest that increased school spending comes not from reallocating existing resources but from expanding the total resources available through taxation.

As a result of both litigation and the desire for property tax relief, state governments have acquired greater control over school funding decisions while reducing its percentage of support coming from the state. In an environment of fend for yourself federalism (Gold, 1989) the various levels of government including school districts are forced to face many unfunded mandates on the federal and state levels. The problem with K-12 public school funding in the United States is that schools are expected to do more – educate more students, increase performance standards, offer more diverse and appropriate curriculum and programs – with less funding (Rothstein, 2002). Ironically, while teachers are being asked to meet ambitious new academic targets, local school district spending patterns have changed very little in the past three decades (Miles, 2001). Economic theory explains this phenomenon as scarcity. Specifically, a world of limited resources attempting to satisfy unlimited human wants.

Overall, about half of school funding in Texas comes from general state revenues and federal grants; the rest comes from local money, primarily property taxes. In fact, the state's share of school funding has been slipping for the past 12 years. In 1990-91, the state share was 47 percent. By 2002-03 it was 39.7 percent. By 2005, the state share of school funding is estimated be 36.3 percent (<http://www.investintexaschools.org>, 2005). But on the district level, that split varies widely. The property poor areas of El Paso and the wealthy suburbs of Dallas and Houston are in stark contrast. Some districts, flush with property taxes, get no state aid. Others depend heavily on state money. To offset

this local variation the state provides funding to districts in an inverse relationship to district wealth. Schools districts with higher property wealth receive less funding than low wealth school districts to equalize overall school funding.

Thus, it is necessary for the legislature to raise tax rates to furnish the same levels of services. As school districts approach the 1.50 per \$100 property valuation cap, the ability of school districts to provide adequate and equitable facilities may be threatened. In a market economy this disproportion of inputs and outputs would be accommodated through the rationing effect of the price system. It is when government places price ceilings that distortions of the natural dynamics of pricing occur and unstable economic environments are created. When districts reach the maximum tax rate, they may need to cut programs and lay off personnel to continue to meet rising costs, such as higher teacher salaries and health care benefits. Reliable data show that Texas' public education system is at 97 percent fiscal capacity. The percentage is projected to increase to 98 or even 99 in the near future (A Report Card on Texas Education, 2002).

Currently, the Texas Education Agency (TEA) projections indicate that approximately 100 Texas school districts will have serious financial problems in the upcoming year (Albanese, 2002). Of these districts, 71 districts were classified with a 'substandard' fiscal rating in the initial Financial Integrity Rating System of Texas (TEA, 2000). A public school district's progression into financial insolvency is often caused by financial exigencies, which include but are not limited to: expenditures exceeding revenues, declining fund balance, stagnant tax rate, declining enrollment, declining property values or error. School finance exists in an economic environment. The

consequences of a districts failure to respond to any of these conditions could force consolidation or put the district into state receivership due to insolvency. Yet, the ramifications could be more widespread because during periods of economic downturns state revenues become uncertain. Even if state allocations remain constant, school districts experiencing growth in student enrollment may find themselves in financial difficulties. Some contend that this method of financing public education is merely a symptom of a larger state wide financial crisis. Yet, there are researchers who have asserted that there are indicators and fiscal tools that could be utilized to both identify economic distress and restructure school district insolvency.

The structure of school finance decisions exists in an unpredictable political environment. Local control creates a setting that often makes decision making appear incremental, influenced by special interests and fluid participators in the decision making process. A practical decision making model for leaders to resolve these issues, requires rational analysis based on purposed guided choices that result in the best alternatives to meet their respective goals.

The reality of the world of the 21<sup>st</sup> Century leader will be one of competition for dollars and customers. The role of the future superintendent will not only entail running a school system but also serving as a broker of services and an ensurer of equity (Houston, 2001). His/her task will be to determine which services are required and strategies that will make sure every child will benefit from them. The responsibility of budgeting cannot be delegated to others (Butler, 2003). The success of leaders in terms

of budgeting will be grounded in their abilities to utilize rational decision-making in a world of environmental uncertainty.

The question of how school districts deal with financial insolvency has largely been ignored by the literature. The literature that there is suggests that due to a general lack of knowledge, school district resort to cost-reduction methodologies that are not cost effective, or are quick fixes, and unrealistic; the process often mirrors state and federal surgery with a blunt scalpel (Cavanagh, 2002). The focus of this study will be on case studies of two school districts in Texas who have emerged from financial insolvency through their approaches to decision-making.

#### Statement of the Problem

Lincoln and Guba (1981) suggest that a problem is a state of affairs “resulting from the interaction of two or more factors...that yields an undesirable consequences...” (p.88). Currently, there is an ever-demanding strain that is placed on state governmental resources and an ever-decreasing ability to generate local revenue. As a result an increasing number of school districts have not maintained their financial stability and have become fiscally insolvent. Insolvency is defined as obligating fiscal resources beyond available resources. The consequences of such a ranking can produce political and economic restructuring of the organization.

Historically, the educational community has assumed that with the existing resources school districts could maintain their financial stability. Within the past decade, we have found that these expectations are not true, as many districts have found their resources insufficient to accomplish their objectives. Currently, there are no studies in

Texas of school districts' decision-making processes that have contributed to 'substandard' fiscal ratings from the Texas Education Agency. Nor have there been studies of school districts that have emerged from such ratings. The focus will be on identifying factors that have contributed to fiscal insolvency and those which have promoted fiscal solvency.

#### Purpose of the Study

The 77<sup>th</sup> Legislative Session of the State of Texas directed the commissioner of education, in consultation of the Comptroller's office, to "...develop and implement a financial accountability rating system for school districts in this state (Canby, 2001). In response to this directive, the Texas Education Agency (TEA) developed the Financial Integrity Rating System of Texas (FIRST), which was implemented for the first time in 2002-03 school year using 2001-02 data. The mandatory data collection required by the Texas Education Agency combined with the development of uniform criteria and standards to identify school districts in fiscal distress, now allows researchers to explore the many technical variables of school finance and their relationship to the economic health of Texas school districts. In doing so the legislature has compelled school districts into a higher state of financial accountability in order to avoid politically embarrassing school district insolvency and to conserve precious state revenues.

The researcher identified selected school districts, which have experienced 'substandard ratings' by the Texas Education Agency and have emerged or made substantial progress toward regaining fiscal solvency. Furthermore, the purpose of the study was to describe the context within which budgetary decisions were made and the

decision-making processes regarding resource allocation. The focus was on identifying factors that have contributed to fiscal insolvency and those which have promoted fiscal solvency.

### Research Questions

- (1) What were the factors that contributed to the districts' fiscal insolvency?
- (2) What were the factors contributing to the districts' regaining fiscal solvency?
- (3) Were the fiscal tools of the Texas Education Agency used in resolving the problem?

### Methodology

This study was qualitative in nature in that it examined two cases of school districts that have received 'substandard' fiscal ratings from the Texas Education Agency and subsequently emerged from those ratings. A quantitative application of four financial ratios will be utilized to ensure the selected schools meet the criteria. The content analysis of interview data was supported by an analysis of primary documents such as board minutes and audits. The respondents that were interviewed include the current superintendent, business manager, school board member and a TEA representative. This qualitative case study was written from a constructivist paradigm.

The cases included in this study were Cedar Hill Independent School District and Uvalde Consolidated Independent School District. The content analysis of interview data was supported by an analysis of primary documents for each case. The inconsistencies between documents and interview information was noted and reported. Each case was organized chronologically and presented as a narrative.

Additionally, a quantitative analysis was performed by the researcher through the application of four financial ratios to each district to further support the reliability of the study. Also, these ratios were used to depict the rational relationships of budgetary items towards economic recovery. A final chapter includes cross-case analysis, implications, conclusions and recommendations.

### Significance of the Study

At the present time, there are few research studies addressing the issue of school district fiscal recovery in terms of the dynamics of choice. Research on school district insolvency has focused on using financial ratios and discriminate function analysis developed for school districts. These data from school district's annual financial reports has been analyzed to predict the fiscal health of a school district, (Saul, 1995), and on developing a model for predicting fiscal insolvency (Finkelstein, 1994). Only the Manca (1997) case studies of California and Nevada schools deviated from the quantitative nature.

This study sought to examine the decision making and perspectives of stakeholders in two school districts in Texas that have been classified as substandard and have either emerged or made substantial progress toward regaining fiscal solvency. The researcher sought to find the following: economic conditions; fiscal decisions; and changes in law that have aided these school districts to regain solvency. Furthermore, the study will assist education policy makers to examine and possibly anticipate problems within their jurisdiction. It has been suggested by Finkelstein that case study research might investigate whether the differences in fiscal stability are more attributable to

spending patterns or to differences in governance (Finkelstein, 1994). One of the benefits of qualitative research is that it can generate information about organizational activities and therefore, become increasingly proactive. Thus, decision makers could be enabled to design strategies for avoiding potential fiscal problems before they become serious (Herndon & Kreps, 1993).

Qualitative research furnishes data for diagnosing and designing strategies to address organizational difficulties. In addition, this study with its case analysis will be useful in attempting to understand which particular components of budgeting practices contribute to fiscal stress and which helped to solve problems in the cases studied. Such practices as allocation decisions, staff discretion, error resolution, technical expertise, communications, and historical patterns of control may emerge as contributors to the fiscal health of the school districts studied.

#### Definitions

For the purpose of this study the following terms are defined as they relate to this study.

Assessed Valuation: Assessed Valuation refers to a valuation set upon real property by the County Appraisal District to be used as a basis for levying taxes.

Audit: An audit is a comprehensive review of the manner in which the government's resources were actually utilized. A certified public accountant issues an opinion over the presentation of financial statements, tests the controls over the safekeeping of assets and makes recommendations for improvements where necessary.



Average Daily Attendance, ADA: The average daily attendance, ADA, is the average number of students who are either present or who have been excused for absence during each day of the school year. The ADA figure is used to calculate a school district's principal apportionment.

Beginning Fund Balance: The General Fund balance on the first day of a new school year. For most school districts this is equivalent to the fund balance at the end of the previous school year.

Budget: The projected financial data for the current school year. Budget data are collected for the general fund, food service fund, and debt service fund.

Budgeting: Not later than August 20 of each year, the superintendent (or designee) must prepare a budget for the school district if the fiscal year begins on September 1. (For those districts with fiscal years beginning July 1, this date would be June 20.) The budget must be adopted before expenditures can be made, and this adoption must be prior to the setting of the tax rate for the budget year. The budget must be itemized in detail according to classification and purpose of expenditure, and must be prepared according to the rules and regulations established by the state board of education.

Capital Outlay: This term is used as both a Function and an Object. Expenditures for land, buildings, and equipment are covered under Object 6600. The amount spent on acquisitions, construction, or major renovation of school district facilities.

Capital Project Funds: Fund type used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds and trust funds.)

Case Study: A case study is an in-depth, multifaceted investigation, using qualitative research methods, of a single social phenomenon (Feagin, Orum & Sjoberg, 1991). A case may be identified as a person, event, time period, critical incident, decision or set of decisions, organization, process, program or institution (Yin, 1994).

Cash: The term, as used in connection with cash flows reporting, includes not only currency on hand, but also demand deposits with banks or other financial institutions. Cash also includes deposits in other kinds of accounts or cash management pools that have the general characteristics of demand deposit accounts in that the governmental enterprise may deposit additional cash at any time and also effectively may withdraw cash at any time without prior notice or penalty.

Categorical Funds: Categorical Funds are money given to a school district by the state or federal government for specific purposes. These funds usually have specified guidelines and limitations on how they are to be expended.

Chapter 41: A key “equity” chapter in the Texas Education Code (TEC) is Chapter 41. This chapter is devoted to wealth equalization through the mechanism of recapture, the recovery of financial resources from districts defined by the state as high property wealth. Resources are recovered for the purpose of

sharing them with low-wealth districts. Districts that are subject to the provisions of Chapter 41 must make a choice among several options in order to reduce their property wealth and share financial resources.

Comptroller Certified Property Value: The district's total taxable property value as certified by the Comptroller's Property Tax Division (Comptroller Valuation).

Debt Service Fund: Debt Service Fund is a governmental fund with budgetary control that accounts for expenditures for the retirement of debt and expenditures for interest on debt, except principle and interest of current loans.

Debt Services: Two function areas (70 and 71) and one Object (6500) are identified using this terminology "debt services." Function 70 is a major functional area that is used for expenditures that are used for the payment of debt principal and interest including Function 71. Expenditures that are for the retirement of recurring bond, capital lease principal, and other debt, related debt service fees, and for all debt interest fall under Function 71. Object 6500 covers all expenditures for debt service.

Deferred Revenue: Resource inflows that do not yet meet the criteria for revenue recognition. Unearned amounts are always reported as deferred revenue. In governmental funds, earned amounts also are reported as deferred revenue until they are available to liquidate liabilities of the current period.

Deficit Spending: Deficit spending by a school district refers to having insufficient allocation of actual or projected income when compared to the actual or projected school district expenditures.

Designated Fund Balance: The designated fund balance represents tentative plans for the future use of financial resources. Designations require Board action to earmark fund balance for bona fide purposes that will be fulfilled within a reasonable period of time.

Discriminate Function Analysis, DFA: Discriminate Function Analysis, is a statistical technique based on multiple regression that allows multiple numbers of continuous independent variables to be combined in such a manner as to form a discriminate function equation that will predict the membership of the sample elements into their nominal categories.

Existing Debt Allotment (EDA): The EDA program was initially authorized by the 76<sup>th</sup> Legislature in 1999. The EDA program provides assistance to school districts in making debt service payments on qualifying debt.

Fiscal Insolvency: For the purpose of this study, fiscal insolvency means obligating fiscal resources beyond available resources.

Effective Tax Rate: Provides the unit with approximately the same amount of revenue it had the year before on properties taxes in both years. A comparison of the effective tax rate to the taxing unit's proposed tax rate shows if there will be a tax increase.

Ending Fund Balance: The amount of unencumbered surplus reported by the district at the end of the specified school year. For most school districts this will be equivalent to the fund balance at the beginning of the next school year.

Expenditures: The cost of goods delivered or services rendered, whether paid or unpaid including expenses, provisions for debt retirement not reported as a liability of the fund from which retired and capital outlays.

Fiscal Year: A period of 12 consecutive months legislatively selected as a basis for annual financial reporting, planning, and budgeting. The fiscal year may run September 1 through August 31 or July 1 through June 30.

Foundation School Program (FSP) Status: The Foundation School Program (FSP) is the shared financial arrangement between the state and the school district, where property taxes are blended with revenues from the state to cover the cost of basic and mandated programs. The nature of this arrangement falls in one of the following status categories: Regular, Special Statutory, State Administered, Education Service Center, or Open Enrollment Charter School District.

Fund Balance: The difference between assets and liabilities reported in a governmental fund.

General Fund: The General Fund is used to account for revenues and expenditures necessary for the day-to-day operation of the school district.

I&S Tax Rate: The tax rate calculated to provide the revenues needed to cover Interest and Sinking (I&S) (also referred to as Debt Service). I&S include the interest and principal on bonds and other debt secured by property tax revenues.

Local Fund Assignment Rate: The district's share of Tier 1 cost, is the amount of revenue that can be raised at the \$0.86 tax rate. Districts with sufficient wealth to

generate the entire allotment on their own at the \$0.86 tax rate receive no state aid in Tier 1.

Local Tax: This is all revenues from local real and personal property taxes, including recaptured funds from 1) Contracted Instructional Services Between Public Schools (Function 91) and 2) Incremental Costs associated with Chapter 41 of the Texas Education Code (Function 92).

M&O Tax Rate: The tax rate calculated to provide the revenues needed to cover Maintenance and Operations (M&O). M&O includes such things as salaries, utilities, and day-to-day operations.

Operating Expenditures: A wide variety of expenditures necessary to a district's operations fall into this category with largest portion going to payroll and related employee benefits and the purchase of goods and services.

Operating Expenditures/Student: Total Operating Expenditures divided by the total number of enrolled students.

PEIMS: A statewide data management system for public education information in the State of Texas. One of the basic goals of PEIMS, as adopted by the State Board of Education in 1986, is to improve education practices of local school districts. The Public Education Information Management System (PEIMS) contains only the data necessary for the legislature and the Texas Education Agency (TEA) to perform their legally authorized functions in overseeing public education. PEIMS encompasses all data requested and received by TEA about public education, including student demographic and academic performance,

personnel, financial, and organizational information. School districts submit their data via standardized computer files. These are defined in a yearly publication, the PEIMS Data Standards.

Plant Maintenance & Operations: The amount spent on the maintenance and operation of the physical plant and grounds and for warehousing and receiving services. Expenditures associated with this functional area are reported under Function 51.

Property/Refined ADA: The district's Comptroller Certified Property Value divided by its total Refined ADA.

Property/WADA: The district's Comptroller Certified Property Value divided by its total WADA.

Recapture: Recapture is a feature of school finance where local districts give the state locally collected tax revenue for redistribution through the Foundation School Program (FSP). The recapture provision in Chapter 41 of the Texas Education Code is a salient feature of the Texas school finance equalization system.

Refined ADA: Refined Average Daily Attendance (also called RADA) is based on the number of days of instruction in the school year. The aggregate eligible days attendance is divided by the number of days of instruction to compute the refined average daily attendance.

Reserve Fund Balance: This is that portion of fund equity, which is not available for appropriation or has been legally separated for a specific purpose.

Revenues: Any increase in a school district's financial resources from property taxes, foundation fund entitlements, user charges, grants, and other sources.

Revenues fall into three broad sources of revenues: Local & Intermediate; State; and Federal.

Rollback Rate: The rollback rate is a tax rate that would provide roughly the same local taxes and state aid per WADA as was available the previous year, plus debt service taxes, and \$0.06.

School Bonds: A school bond is a debt issued by a school district through a public bond sale for which the school district has secured a voter levy by which to pay the debt.

School Year: The twelve months beginning September 1 of one year and ending August 31 of the following year or beginning July 1 and ending June 30. Districts now have two options.

Special Revenue Fund: A governmental fund type used to account for the proceeds of specific revenue sources (other than for major capital projects) that are legally restricted to expenditures for specified purposes.

State Revenues: Revenues realized from the Texas Education Agency, other state agencies, shared service arrangements, or allocated on the basis of state laws relating to the Foundation School Program Act. This amount is recorded as Revenue Object 5800.



Tier 1: The combination of state and local funds provides access to the same level of educational resources at the same tax rate. All revenue within Tier 1 is equalized.

Tier 2: Tier 2 provides substantially equal access to resources at substantially equal tax rates. The Tier 2 calculation provides additional funding to school districts with low property values to equalize the revenue per WADA available at a given tax rate. Not all revenue within Tier 2 is equalized.

Undesignated Fund Balance: This is that portion of fund equity that is currently available to finance expenditures not already approved by the Board of Trustees.

Undesignated Unreserved Fund Balances: Available expendable financial resources in a governmental fund that are not the object of tentative management plans (i.e., designations). One primary criterion of rating agencies for school bonds is the relative amount of undesignated unreserved fund balance. Bond rating agencies view undesignated unreserved fund balances as a reflection of the financial strength of school districts and show concern when district fund balances decrease.

Unfunded Debt: Unfunded debt such as revenue bonds, loans for capital improvement projects, capital leases, unamortized retirement benefits or insurance funds, and accrued vacation pay are the encumbrance of debt by a school district for which no voter approved levy has been approved. Such debt must be repaid by the school district through its own resources and may threaten the financial position of its general fund.

WADA: A Weighted Average Daily Attendance (WADA) is used to measure the extent students are participating in special programs. The concept of WADA is effect converts all of a school district's students with their different weights to a calculated number of regular students required to raise the same amount of revenue. The greater the number of students eligible for special entitlements, the greater a school district's WADA will be.

#### Assumptions

The issues involved in this study were very complex and they required an approach that allowed for discourse between the researcher and respondents to better understand the prior conditions and decisions that led to the fiscal problems of each school district. The number of school districts suggested by a panel of experts and Texas Education Agency database was small allowing the researcher to conduct qualitative case studies.

Other assumptions included:

1. It was assumed that school districts prepare and report financial data accurately, uniformly, and truthfully.

#### Limitations of the Study

The following limitations are inherent in the study:

1. The results of the study are subject to weaknesses inherent in the qualitative research design.

## Delimitations of the Study

This study involved only school districts that were identified by a panel of experts on school finance as having experienced a substandard rating by the Texas Education Agency since the ratings inception and which have recovered or are in the process of substantial recovery from fiscal insolvency.

## Summary

The remainder of this study is organized into four chapters. Chapter Two represents a review of the literature related to budgeting, decision-making models, school finance legislation and litigation, and fiscal distress. The review concentrates on these topics in the framework of the state of Texas.

Chapter Three describes the methodology and procedures used to investigate the research questions presented in Chapter One. Chapter Four documents the findings of the study for each research question. Chapter Four also furnishes an analysis and evaluation of these findings.

Finally, Chapter Five provides a summary of the research, the findings, conclusions drawn from those findings, and implications for use and future research areas.

## CHAPTER II: REVIEW OF THE LITERATURE

### Introduction

Public school finance is one of the most discussed and least understood aspects of public education (Odden & Picus, 1992). Understanding public school finance in Texas requires knowledge of its historical context and an understanding of issues of adequacy and equity (Alexander & Salmon, 1995). The annual property tax bill and occasional letter to the editor constitutes many Texans' working knowledge of public school finance. A closer look at adequacy issues reveals terminology such as funding tiers, weighted allotments and wealth sharing formulas inherent in school finance. These often leave the average public stunned and perplexed, struggling to translate the political and economic rhetoric that often finds basis in irrational resource allocation strategies.

The historical picture of school finances in Texas was one that was laden with conflict. This struggle involved local and state governments, changing legislative and judicial mandates, periods of turbulent systemic changes as well as conflicting perceptions regarding the impact of school finance decisions on educational processes and outcomes. Walker and Kirby (1988) describe the history of the public school finance system as one of slow development marked by inequities and intermittent crisis. Public perception of the Texas school finance system has ranged from extreme optimism to fortified resolve to unconcealed cynicism. "School finance reform in Texas was like a Russian novel: it's long, tedious, and everyone dies in the end"(Yudof, 1992).

This chapter focuses on related literature, which explores the following: 1) public budgeting defined; 2) budgetary decision making models; 3) history of the Texas public

school finance system; 4) the structure of the current educational finance system and 5) major changes resulting from recent legislative and judicial actions. Literature that furnished an overview of accountability models and standards of fiscal distress for Texas school districts are explored. There is a focus on the concept of bankruptcy as it applies to corporate and educational worlds. A review was then made of models used in both private industry and in public education to predict insolvency of school districts. Finally, there is a section that describes processes for forecasting fiscal health.

## Public Budgets

### *Budgeting Defined*

The term budgeting suggests a variety of interrelated concepts in the resource allocation process. Hence, a specific and comprehensive definition is difficult. In the literature, several definitions are given, each of which may be accurate, depending on the individual's perspective. In its simplest form, "A budget is the financial expression of the intended activities of an organization or a government" (Premchand, 1998, p. 25). In a very general sense, Wildavsky and Caiden (1997) described budgeting as a process "concerned with translating financial resources into human purposes. It is a series of goals with price tags attached to it" (p. 125). Several other budgetary viewpoints also exist. For example, both Kramer (1979) and Stedry (1960) furnished very comprehensive explanations. They described a budget as a multipurpose document providing an estimate of future costs, and outlining a systematic plan for utilization of manpower, material and other resources. Lynch (1979) offered an excellent operational definition applicable to administration of public affairs.

Budget is a plan for the accomplishment of programs related to objectives and goals within a definite time period, including an estimate of resources required together with an estimate of the resources available, usually compared with one or more past periods and showing future requirements (p.5).

Agryris (1954) described the budget as a “fiscal goal, a production challenge in industry” (p.15) and a constant reminder a goal has to be met. Thus, he argued, budgets are constant motivating factors, a perspective Mintzberg (1994) has since questioned. For Mintzberg, the budget is designed for organizational control and less for motivation.

Smithies (1955) contended every governmental decision has budgetary implications since the process of decision-making almost invariably involves allocation of scarce resources among alternatives. He identified six decision-making stages through which budgetary functions are reflected. These stages include determination of policy objectives, planning, programming, budget formulation, budget execution and budget review.

According to Lee and Johnson (1973), budgets in public agencies often assume additional purposes. Budgets that are determined by the prevailing political, social, and economic conditions of the day become the government’s resource allocation strategy. Kraan (1996) supported this viewpoint in his assumption that budgetary decisions are the output of the political system, a function of the environment and the system’s characteristics. Musgrave (1959) outlined what he regarded as the most fundamental functions of public budgeting: to secure adjustments in the allocation of resources, distribute income and wealth, and secure economic stability. The process of “who gets what, when, and how” characterizes an environment Wanat (1978) called “plain and

simple politics” (p. 10). Also, the political tendency toward extravagance in a democracy often influences core budgetary decisions, as well as the decision makers in the budgetary process (Cyert, 1975).

Drake and Roe (1994) defined a school budget as “the translation of prioritized educational needs into a financial plan which is interpreted to the public in such a way that when formally adopted it expresses the kind of educational program the community is willing to support, financially and morally, for a one-year period” (p. 70). Furthermore, these authors claimed the benefits of budgeting in an educational setting to be the following:

- (1) Budgeting establishes a plan of action for the coming year.
- (2) Budgeting requires an appraisal of past activities in relation to planned activities.
- (3) Budgeting necessitates work plans.
- (4) Budgeting provides security for the administration by assuring the financing and approval of a year’s course of action.
- (5) Budgeting necessitates forecasting expenditures and estimating revenues.
- (6) Budgeting requires orderly planning and coordination throughout the organization.
- (7) Budgeting establishes a system of management controls.
- (8) Budgeting provides an orderly process of review and planning for both personnel and facility needs.
- (9) Budgets may serve as a public information device.

## Budget Decision Making Theories

The three models of budgeting focused on in this study are incrementalism, rational approaches and garbage can theory. These are not the only theories of budgetary decision-making, but they are frequently referred to in the budget literature (Thurmaier & Willoughby, 2001).

### *Incrementalism*

The literature on budgetary decisions in the public sector is dominated by the theory of incrementalism and its various meanings (Berry, 1990). This theory advocates that policy makers use ‘rules of thumb’ in order to deal with the technical complexity of expenditure decisions. Wildavsky (1964), the founder of this theory, suggests that the people who design the budget are concerned with relatively minute increments to an existing base denoted as the fair share. Thus, it follows that budgeting is incremental to the extent that it results in marginal changes in expenditure. The evidence of substantial annual shifts in spending would account for non-incremental budgeting.

The influential piece that tested incrementalism was Otto et al. (1966). These authors empirically tested for and found support of the regularity of expenditure changes in 56 federal agencies in the U.S. between 1947 and 1963. Regularity represents the idea of routine behavior in expenditure decisions. This view of incrementalism as regularity rather than marginality was found in the work of Dempster and Wildavsky (1979). Therefore, incrementalism has two core attributes – marginality and regularity in outputs.

Lindblom (1975) asserted the incremental method is the most common through which public policy decisions are made. According to Lindblom, this method is taken for



granted rather than formalized because it is commonly practiced. The author stated that incrementalism is characterized by the practitioner's preoccupation with the following:

- (1) A limited set of policy alternatives that are politically relevant,
- (2) Analysis of those aspects of policies with respect to which of the alternatives differ,
- (3) The policy choice as one in a succession of choices,
- (4) Marginal values of various social objectives and constraints,
- (5) A mixture of evaluation and empirical analysis rather than empirical analysis of the consequences of policies for objectives independently determined,
- (6) A small number of all the important relevant values.

Hence, the policy maker concentrates on one or two of the many policy goals. They limit the alternatives and rely heavily on the record of past experiences. This is safe, flexible and self-adjusting. Therefore, the incremental administrator might lack innovation, insight or forethought. Instead, they might make policy choices by reducing complicated problems to their simplest form and make marginal adjustments to previous successful budgetary decisions.

### *Rational*

The second model is the rational model, which is embedded in economic theory. This model seeks to describe the conditions that maximize efficiency, effectiveness, and certainly by identifying all available options and choosing the best alternatives. Perhaps the most fundamental assumption is "complete and perfect information about all alternatives is both available and manageable" (Lee and Johnson, 1973. p. 19). This

decision-making method is often cited as the best way to make public budgeting decisions (Lynch, 1979).

The fundamental principle of the rational decision making model is reflective analysis. In budgetary decision making, reflective analysis is essential as decisions are made about fiscal allocations to one activity instead of another (Key, 1940). The rational administrator uses a budgetary approach that connects inputs or dollars and outputs or goals in the resource allocation process. Their decisions are not random, accidental, or rationalized after the fact. Resource allocation is often mathematically determined and evaluated by the assumption that the best possible results will be produced efficiently and effectively. There are at least six rationally objective budgeting methods. These methods include: 1) performance budgeting; 2) program, planning and budgeting; 3) zero-base budgeting; 4) formula budgeting; 5) mission budgeting and 6) strategic budgeting.

### *Garbage Can*

The garbage can theory was first developed by Cohen et al. (1972) to describe decision-making in colleges. It articulates that these educational institutions face decision situations involving unclear goals, unclear technology, and fluid participants. In this model, active decision-makers and problems follow one another through a series of choices without great progress in solving problems. Some of the organized anarchical features of this model have been revised and extended to public institutions in general (Kingdon, 1984).

The most important feature of the garbage can theory involves four independent streams of decision-making: 1) problems; 2) solutions; 3) participants; and 4) choice

opportunities. The organization centers on a collection of choices looking for problems. The decision-makers have already devised the strategies to solve the problems, but are waiting for the appropriate time and place to employ them. The garbage can theory is founded on a radically different approach to choice than the rational model. Its fundamental premise is that decisions in an organized anarchy cannot be understood using the intentions of organizational participants, and imposing a rational explanation on organizational behavior can only distort what is really going on (Bendor et al., 2001).

The garbage can theory administrator might make choices not necessarily logical, but dependent upon such matters as the timing of the decision; the availability of other decision opportunities; and the participants at the time.

#### Background: Evolution of Texas School Finance 1836-Present

Most Texans fail to recognize that our philosophies of education, our organizational structure, and particularly our financing methods for public schools were the products of over 150 years of evolution (Walker, 1990, p.2). The Texas school finance system evolved similar to systems throughout America over the past two-plus centuries (Pierce, 1989). Burrup and Brimley (1998) noted that these evolutionary patterns in public school finance theory and practice generally fit into five distinct periods:

- 1) the period of local district financial responsibility with little or no assistance from the state;
- 2) the period of emerging state responsibility with the use of flat grants, subventions, and other nonequalizing state allocation to local districts;
- 3) the period of emergence of the concept of a foundation program;

- 4) the period of refinement of the foundation program concept; and  
the presently emerging period of equalization practices and stress on high  
quality education (p. 133).

Texas officials included a provision for public education in the newly formed Republic of Texas with the Constitution of 1836. But it was not until the Constitution of 1845, when Texas was admitted to the United States, that the Legislature was assigned the responsibility for establishing free public education throughout the newly formed state of Texas. This constitution also furnished for the first funding of public education through the use of state taxes on property. But “land was so abundant in Texas that it held little value; therefore, funds for education largely were absent” (Walker & Casey, 1996).

The Compromise of 1850 brought the next evolution of public education in Texas. Its passage brought ten million dollars to the state for relinquishing its western lands. Out of this lump sum, two million dollars plus previously appropriated but unused funds were used for the establishment of a permanent endowment fund for public school education in the School Law of 1854. This fund’s revenues were to be distributed annually. Also, this law required that counties be divided into school districts and that revenue sources from local governments be employed for constructing school buildings. The School Law of 1854 was viewed as a historic benchmark in the public school finance arena. Paradoxically, the predominant number of schools in Texas was still private “public schools” and many Texans did not believe in the need for free public schools (Walker & Kirby, 1988).

A new constitution was designed in 1869 during the post-Civil War era. The most highly centralized system for public education was mandated for Texas in this document. The Permanent School Fund was revived and also an Available School Fund was initiated. The Constitution of 1869 made for compulsory school attendance for the first time in Texas history for all children eight to fourteen. There was an intense controversy, which arose over the provisions regarding local property taxes and the required districting of counties. Controversy and animosity over these issues continued to exist among Texans for several decades (Walker & Casey, 1996).

A new Texas constitution was developed in 1876 due to the significant opposition to its predecessor. A new education article was added in the Constitution of 1876, which provided for financing public school education through a flat per capital grant. This grant was to originate from the Available School Fund and would consist of income from the Permanent School Fund coupled with a maximum of one-fourth of the general revenue collected from the state. Montgomery (1993) stated that one of the provisions in the 1876 Constitution forbade school districts in rural areas from levying and collecting local school taxes (p. 14). The result was a disparity of resources within the Texas public school system.

The first major legislative action of the 20<sup>th</sup> Century to furnish additional support to rural schools came in the form of an appropriation made by the 1915 Texas Legislature. This came in the form of \$1 million per year for the next biennium (1916-1917) for rural school equalization aid and was a result of Governor James E. Ferguson's campaign promise. The legislature acknowledged that rural school districts were

incapable of raising adequate funds even with the equalization of taxing capacities called for through a 1908 amendment to the Constitution. In 1919 the Texas Legislature, with Governor William P. Hobby's support, made its first appropriation from the general revenue fund to optimize the per-capita apportionment for Texas schools. "The Texas Legislature has from 1919 forward always exercised its general appropriation authority for state aid grants" (Hobby & Walker, 1991, p. 380).

The recommendations of the Gilmer-Aikin Committee brought the next major finance reform in Texas. This committee was appointed by the Texas Legislature in 1947 and was given the responsibility to organize a new system of public school finance (Walker & Kirby, 1988). This committee's proposals were documented in 1948 in a report entitled *To Have What We Must*. These proposals established the Texas Minimum Foundation Program, later renamed the Foundation School Program (Watson, 1996). These programs designated that the state would furnish 80 percent of the funding from the general revenue and allow local school districts to fund above the state level.

Revision in state school finance was evident by 1965. Governor John Connally, that same year, established an interim committee named the Governor's Committee on Public School Education. This committee released their report, *The Challenge and The Chance*, in 1968.

This report called for a complete overhaul of public education in Texas, consolidation of small school districts, a more comprehensive minimum foundation program, and increased state funding of public education. Unfortunately, the report and its recommendation were ignored by the Legislature (Connors, 1991, p. 184).

A new governor was taking office, equalization needs in Texas school finance were once again ignored, and the state was moving closer to experiencing major ramifications regarding the neglect of equity issues in the state's school finance practices (Walker & Kirby, 1988, p. 18). These ramifications became evident in 1971 when a U.S. District Court, in the case of *Rodriguez v. San Antonio ISD*, declared the method of funding public education used by the state was unconstitutional based on the violation of the equal protection clause of the Fourteenth Amendment in the U.S. Constitution (Watson, 1996, p. 380). The timeframe of 1973 to 1983 saw each legislative session wrestling with the task of providing more funding to poor school districts yet these equalization efforts had little impact.

The problem of equalization was addressed by the state legislature at different intervals during this timeframe. The Legislature in 1973 waited for a decision to come from the United States Supreme Court. On appeal, the U.S. Supreme Court heard arguments and in 1973, the Court overturned the lower court decision. The Court stated that the Texas school finance system was not unconstitutional, it referred the case back to the state for remediation and further reiterated that education was not a fundamental right protected by the U.S. Constitution. Justice Powell wrote the majority opinion for the 5-4 decision in *Rodriguez v. San Antonio* (1973). He noted that although disparities between school districts did exist, the state was trying to remedy the situation by creating a minimum foundation program. As he stated:

The District Court's opinion does not reflect the novelty and complexity of the constitutional questions posed by appellees' challenge to Texas' system of school financing. In concluding that strict scrutiny was required, that court relied on decisions dealing with the rights of indigents

to equal treatment in the criminal trial and appellate processes, and on cases disapproving wealth restrictions on the right to vote. The cases, the District Court concluded, established wealth as a suspect classification. Finding that the local property tax system discriminated on the basis of wealth, it regarded those precedents as controlling. It then reasoned...that there is a fundamental right to education, and that absent some compelling state justification, the Texas system could not stand. (pgs. 17-18)

Texas was challenged within the court decision to examine its system of finance because it was “chaotic and unjust...the ultimate solution must come from the lawmakers and from democratic pressure of those who elect them (Rodriguez, p. 1310).” The first level of reform began in 1975. The state equalization aid bill was passed, and the method of calculating the local share of the foundation school program was modified in the last few hours of the session. The bill was a “compromise measure that made notable revisions to the state’s financing plan (Walker & Casey, 1996, p. 10).” It furnished the theoretical framework for equalization aid to property-poor districts and did away with the complicated economic index formulas of the Gilmer-Aikin Plan. While Senate Bill 1, passed in a July 1977 special session of the Legislature, increased the foundation program aid while reducing the local fund share. Also, the School Tax Assessment Practices Board was created to establish uniform guidelines for the appraisal of property. In 1979, Senate Bill 350 again raised the foundation level of support, increased equalization aid, increased state compensatory funding, wrote a new transportation formula and addressed the needs of growing districts.

The issue of taxpayer equity continued to be of interest. Senate Bill 621 and House Bill 1060 combined to provide a measure of reform in property taxation, including truth-in-taxation requirements, enabling of the Tax Relief Amendments of 1978, and establishment of countywide tax appraisal districts to bring uniformity and equity in property appraisals (Walker & Casey, 1996, p. 10).



The 1981 Legislative session again increased the foundation program and equalization formulas. Teacher salaries were the main reason for the increases. The local fund assignment rate was again lowered. While transportation aid was increased. House Bill 30 passed in a special session, attempted “to clarify previous property tax legislation, postponed for two years mandatory school district participation in central appraisal districts, and added several features to the Property Tax Code” (Hair, 1989).

Tremendous turmoil characterized the Texas school finance system in 1983. Both oil and gas prices fell dramatically for the first time in many years. This phenomenon led to no increase in state tax revenue with a major recession in Texas. Thus, the state fell into the position of having to either raise taxes or cut spending. Dallas businessman Ross Perot was chosen to chair a Select Committee on Public Education in response to this economic crisis. The committee was charged with investigating the state system of education in Texas with a goal of reforming in a special session of the Legislature in 1984. The Select Committee reported its recommendations in April 1984, and its recommendations included the elements presented as House Bill 72 in which virtually every aspect of the Texas public school education system, including public school finance, went through major revisions (Montgomery, 1993). House Bill 72 was a school reform law that attempted to avert legal disputes, yet it was inundated with considerable controversy. “The main equity improvements in the state finance structure deriving from House Bill 72 were

- (a) increased local share rate;
- (b) increased equalization aid; and

(c) reduction of Available School Fund payments to budget-balanced districts”(Camp & Thompson, 1988, p. 226).

Therefore, much of the responsibility for funding the delineated reforms was left to the local districts, with many districts not being adequately equipped to handle his financial burden.

*A Guide to Texas School Finance* (Texas Center for Educational Research, 2003)

describes the structure of the present Texas public school funding system as follows:

It is a shared arrangement between the state and local school districts where the state provides funding to school districts in inverse relation to district property wealth. State and local funds are distributed through a system of formulas known collectively as the Foundation School Program (FSP). The FSP system consists of three tiers, the first two of which include a number of adjustments and weights designed to distribute funding according to the characteristics of the school district and its students while tier 3 provides support for facilities. More specifically, tier 1 is the base or foundation funding level which provides for individual allotments corresponding to program categories such as regular education, special education, compensatory education, bilingual education, career and technology education, gifted and talented education, the public education grant program, and transportation costs. Tier 2 provides equalization funds to school districts beyond the base funding level in Tier 2 generating resources for education in the form of a guaranteed yield. Tier 3 is another level of guaranteed yield program designed to provide funding specifically for facilities needs (p. 1-8).

In summary, the present system of Texas public school finance is based upon a generally held belief that improved student achievement is a result, to some degree, of the amount of financial resources dedicated to that particular initiative (Picus, 1995). As a result, a school funding structure has evolved which attempts to provide a high level of equalization to all schools throughout the state (Texas Center for Educational Research, 2003).

## Review of School Finance Litigation

The Tenth Amendment of the Constitution of the United States, stated “powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved for the States...” Because education is not mentioned in the Federal Constitution it has historically been a legislative and judicial concern of the state (Thurston, 1990).

Odden and Picus (1992) reviewed the key legal issues embedded in school finance litigation. One important issue addressed in arguments involving school finance litigation questions how the school finance structures conflict with federal and state constitutions. More specifically, do they conflict with either the Equal Protection clause of the Fourteenth Amendment of the Federal Constitution and state constitution in which the school system originates? This consideration revolved around two sub points.

- 1) Was education a “fundamental right”?

- 2) Did the circumstances involved create an argument for a “suspect class”?

If either of these points were true, then this would necessitate the use of “strict judicial scrutiny” by the courts.

Over several decades, a large body of litigation has challenged school finance systems in states across the nation. The issues that are the subject of school finance litigation are often complex and far-reaching. The courts have played an important role in reshaping educational policy as school finance and governance become more closely interrelated and as the movement toward nationwide and state educational standards gain

momentum (VanSlyke, 1994). Cases may be separated into decisions based on state equality provisions and those based on state education clauses.

State equality guaranty clauses are one means through which reformers have sought to challenge education financing in the states. The use of the equality clause has met with limited success. Plaintiffs have used a state equality provision as the basis for overturning school funding systems in five Supreme Court cases. Four of the rulings are as follows:

- (a) *Serrano v Priest II*, in 1976, defined fundamental rights as “those individual rights and liberties that lie at the core of our free and representative form of government” (557 P.2d at 952). The Court referred to many sources to establish the vital role of education, stating that education is as important as two other fundamental rights-the right to vote and the rights of criminal defendants (Banks, 1991, p. 143).
- (b) *Pauley v. Bailey*, in 1979, and *Washakie v. Herschler*, in 1980, used the same test to find that education was a fundamental right; both the West Virginia and Wyoming courts relied on the “explicitly or implicitly guaranteed” test of *Rodriguez* (Banks, p. 144). Cases that have attempted to establish education as a right that is explicitly guaranteed by the state constitution have met with little success.
- (c) *Horton v. Meskill*, in 1977, came to the conclusion that education was a fundamental right under the state constitution through an examination of “the degree of support given to education by the legislature throughout the state’s

history”(Thro, p. 1676). Essentially, because the court found that the practice for centuries had been to act as if it was Connecticut is duty to provide education to its children the “duty had assumed the status of a constitutional obligation”(Banks, pp. 149-150).

The fifth case did not address the issue of fundamentality. In *Dupree v. Alma*, in 1983, the court used a rational basis test to determine if the Arkansas government had a rational basis for financing the school system as it did. The court found that the state system was irrational. As one commentator noted, the Arkansas interpretation of the rational test has “more bite” than the federal rational basis test (Thro, p. 1671 n. 147).

The equal protection clause was used effectively in some cases in the 1970s; another avenue for litigation was state education provision. Arguments alleging that a state’s educational financing system violates the education clause in its constitution have become increasingly successful in overturning school funding systems. Some of the cases where courts ruled school-funding systems unconstitutional based solely on the education clause include:

- (a) *Robinson v. Cahill*, in 1973, the court ordered school financing reform after determining that the state’s constitutional mandate for “thorough and efficient” education required an equal opportunity for all children, a mandate that the court felt was not being met because of funding disparities present in the existing system (Thro, p. 1656).
- (b) *Abbot v. Burke*, in 1985, the New Jersey court went beyond its decision in *Robinson* and decided that a “thorough and efficient” education requires an

educational system that provides disadvantaged students the opportunity to compete with their advantaged peers. As a result, the existing school financing system was ruled unconstitutional, although only for the 28 poorest school districts in New Jersey [495 A.2d 376 (N.J. 1985).] This decision was particularly important because it not only implied an equal spending criterion, but it also recognized that the needs of poor children will require the state to spend even more on these students than it does when educating other students (VanSlyke, 1994). In a series of *Abbott* rulings, the New Jersey Supreme Court has ordered the state to address deficiencies in its 30 poorest districts. The orders spell out what must happen in those poor districts in order for the state to comply with its constitution. The court held that 1) the Commissioner of Education must designate schools as low or high performing; 2) low performing schools must undergo a review and planning process to make informed decisions about school and/or program improvement pursuant to agreement developed by a performance assessment team, a school management and improvement team, and the district; 3) the school management and improvement team may develop a plan for high performing schools in consultation with the district central office; and 4) a collaborative work group must be established to develop protocols and guidance for a program of whole school reform in *Abbott* district middle and high schools (Abbott v. Burke, N.J. June 24, 2003).

- (c) *Seattle School District No. 1 v. State*, in 1978, the Washington Supreme Court overturned its decision four years earlier in *Kinnear*, which had found the system of school financing constitutional (Thro, p. 1669). The court reinterpreted the state's education clause to impose a duty on the state.
- (d) *Rose v. Council for Better Education, Inc.*, in 1989, the state supreme court considered "whether the Kentucky General Assembly has complied with its constitutional mandate to provide an efficient system of common schooling throughout the state (Rose, p. 189). The court ignored the avenue of the equal protection provision and stated the issue as whether the present financing system was "efficient." In a decision unprecedented in the history of school finance reform, the court ultimately decided that Kentucky entire system of common schools was unconstitutional (Thro, p. 1664 n. 113).

#### Review of School Finance Litigation in Texas

A review of judicial level decisions reveals that five landmark decisions have profoundly shaped Texas' school funding system. These decisions are:

- (a) *Rodriguez v. San Antonio Independent School District*, in 1973, successfully argued that the Texas system of public school finance discriminated against children living in property poor school districts, and denied equal protection for those same students ("An Introduction," 1990);
- (b) *Edgewood I*, in 1989, successfully argued that funding for Texas school districts must be substantially equal at similar rates of taxation (Whitney & Hightower, 1992);

- (c) *Edgewood II* (the determination of the constitutionality of Senate Bill 1 of 1990) declared that the system was unconstitutional because it did not remedy the cause of opportunity gaps between rich and poor school districts (Whitney, 1992);
- (d) *Edgewood III* (Carrollton-Farmers Branch I.S.D. v. Edgewood I.S.D.), in 1992, determined that the 188 County Education Districts created by Senate Bill 351 were unconstitutional in that they represented a state ad valorem tax which is unconstitutional (Sparkman & Carpenter, 1994); and
- (e) *Edgewood IV* (the determination of the constitutionality of Senate Bill 7 of 1993), found that the system of public school finance based on wealth reduction by property rich school districts was constitutional (Whitney & Crampton, 1995).
- (f) *West Orange-Cove v. Alanis*, in 2003, the plaintiff school districts argued in district court that they had been forced to tax at the maximum tax rate in order to educate students as required by Texas law and rule. The district court dismissed the plaintiffs' suit in July 2001 and the Third Court of Appeals affirmed the decision in April 2002. The case was appealed to the Texas Supreme Court where the court reversed the lower court ruling and remanded the case to district court for a trial. Four districts, including West Orange-Cove CISD, contended that the cap on operations tax rates represented an unconstitutional state property tax, originally brought this lawsuit in 2001.



However, the suit now seeks broad changes to the entire school financing structure (TASB, 2003).

Successful school finance litigation poses significant challenges to educational policy. The courts have often ruled that existing school finance systems are unconstitutional though a multiplicity of views exists on how states should facilitate broad concepts. These concepts range from equal educational opportunity to revenue and resource allocations systems. The courts and the legislatures must weigh conflicting research that have legal, political and economic factors in constructing new financing arrangements.

#### Review of Fiscal Accountability Legislation in Texas

Senate Bill 7 (1993) was enacted by the 73<sup>rd</sup> Legislature, effective for school years 1993-94 to present. The primary focus of this bill was wealth equalization for all school districts at a level of \$280,000 per weighted average daily attendance (WADA). Currently, school districts with wealth above the statutory threshold of \$305,000 per WADA are affected.

According to Texas Education Code, those school districts that exceeded this established wealth level (known as Chapter 41 districts) had five options from which to choose to accomplish this mandate:

Option 1 - Consolidation by agreement. The school boards of two or more districts may agree to consolidate in order to create a new district with wealth per pupil of less than the statutory wealth threshold.

Option 2 - Detachment and Annexation by Agreement. The school boards of two or more districts may agree to detach property from one school district and attach it to one or more school districts. The wealth of the district from which property was detached may not exceed the statutory wealth threshold per WADA. The wealth of any district to which property was attached may not exceed the guaranteed yield level per WADA.

Option 3 - Purchase of Attendance Credits. A district with wealth per WADA above the statutory threshold may purchase attendance credits from the state. One attendance credit is equal to one student in WADA. In effect, the district sends a check to the state.

Option 4 - Contract for Education of Nonresident Students. A district with wealth above the equalized level may enter into an agreement with a qualifying district to pay the cost of educating students in that district. The paying district provides the receiving district with revenue per weighted pupil equal to the amount spent in the paying district. Weighted pupils from the receiving district are added to the paying district's student count. Under this option, the state deducts the average entitlement from the receiving district, and any excess funds from the sending district entitlement from the receiving district, and any excess funds from the sending district are left for the receiving district.

Option 5 - Tax base Consolidation. The school boards of two or more districts may agree to conduct an election to create a consolidated taxing district for the maintenance and operations of the two school districts. The resulting taxing

district may not have a property wealth per pupil above the equalized level (Texas School Law Bulletin, 2002).

Each of the five options required local voter approval before implementation, thereby compensating for one of the major shortcomings found by the court with Senate Bill 351. Senate Bill 7 was also reviewed by the legal system and was found constitutional on January 30, 1995.

Senate Bill 7 also provided a hold harmless clause that allowed all districts classified as property wealthy to continue to raise the same amount of funds per weighted average attendance for three years (through 1995-96) as each district raised per weighted average attendance during the 1992-93 school year (“School Finance,” 1995).

The equalization provision of Senate Bill 7 initially affected 99 of the 1,046 districts that had taxable value in excess of \$280,000 per weighted average daily attendance. Each of the identified districts was required to hold an election during the fall of 1993 for voters to determine an option, or combination of options, which would reduce local wealth to the statutory limit. One district elected to detach property to lower its wealth, fifty-two districts approved the purchase of weighted attendance credits, eight districts voted to educate non-resident students, and thirty-eight districts voted for a combination of purchasing weighted average daily attendance credits from the state and educating non-resident students (Sparkman, 1994). The total reduction of value resulted in the recapture of more than \$430 million in local property taxes in 1993-94 (“School Finance,” 1995).

TEA identified 118 districts subject to the wealth sharing provisions of Chapter 41 for the 2002-03 school year. In 2003-04, 134 districts serving over 500,000 students were subject to Chapter 41. All of these districts chose either Option 3, the purchase of attendance credits, or Option 4, education of non-resident students. Both Options 3 and 4 recaptured revenue from high-wealth districts. Some people refer to the provisions of Chapter 41 as the “Robin Hood” plan (TASB, 2003).

*Texas Performance Review*

The Texas School Performance Review (TSPR), directed by Texas State Comptroller Carole Keeton Strayhorn, was the nation's first and leading state-level program that was designed to improve the management and finances of individual public school districts. Since its inception in 1991, TSPR has conducted nearly 100 audits of public school districts and recommended net savings totaling three quarters of a billion dollars. This number is continually growing since the Comptroller and the Texas Legislature have directed TSPR to conduct 20 reviews each year. In each review, the TSPR team identifies a district's administrative, organizational and financial problems and recommends ways to cut costs, increase revenues, reduce overhead, streamline operations and improve the delivery of educational services.

A TSPR review was a more than a traditional financial audit. TSPR examines a district's operations in a dozen vital areas, including: (1) organization and management; (2) educational service delivery; (3) personnel management; (4) community involvement; (5) facilities use and management; (6) financial management; (7) asset and risk

management; (8) purchasing and warehousing functions; (9) computers and technology; (10) food services; (11) transportation and (12) safety and security.

After the Comptroller chooses to conduct a review or accepts a district's invitation, TSPR begins interviews, holds town hall meetings and focus group sessions with community leaders, school organizations, parents, school administrators, teachers, district personnel and students to gauge community attitudes and expectations. This method does utilize qualitative findings in comparison to TEA “numbers-based” school district financial accountability system (S.B. 875). TSPR defines a financially poorly performing district as one with a lower than appropriate fund balance, a high property tax rate and low staff to student ratios in comparison to state averages in these areas (<http://www.window.state.tx.us/tspr/tsprqa.html/>, 2003).

*Senate Bill 218 (2001)*

The 77<sup>th</sup> Legislature conceptualized financial accountability of public schools in Texas through the cosponsoring by Senator Florence Shapiro (R-Plano) and Representative Wayne Smith (R-Baytown) of Senate Bill (SB) 218. This piece of legislation included the following:

- (a.) Requires the commissioner of education and the comptroller of public accounts to develop and implement a financial accountability system for school districts.
- (b.) Requires school districts to complete the financial management report and hold hearings for public comment (Senate Research Center, 2001, p. 90).

The historical precedent of this legislation was Senate Bill 875, 76th Texas Legislature, 1999, which added TEC, §39.201, requiring the commissioner of education in consultation with the comptroller of public accounts to develop proposals for a school district financial accountability rating system that was to be presented to the legislature no later than December 15, 2000. TEC, §39.201, expired September 1, 2001. Subsequently, SB 218, 77th Texas Legislature, 2001, added TEC, §§39.201-39.204, requiring the commissioner to adopt rules for the implementation and administration of the financial accountability rating system prescribed by TEC, Chapter 39, Subchapter I (Commissioner Rules).

The adopted new 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability Rating System, includes provisions that detail the purpose, ratings, types of ratings, criteria, reporting, and sanctions for the financial accountability rating system, in accordance with SB 218, 77th Texas Legislature, 2001. The adopted rules include the financial accountability rating form entitled "School FIRST – Rating Worksheet" that explains the indicators that the Texas Education Agency will analyze to assign school district financial accountability ratings (Appendix A). This form specifies the minimum financial accountability rating information that a district is to report to parents and taxpayers in the district. The rating system indicators are organized into the following areas:

- Critical Indicators (#1-5)
- Fiscal Responsibility (#6-10)
- Budgeting (#11-14)

- Personnel (#15-17)
- Cash Management (#18-21)

The fiscal impact was designed to be to school districts that failed the financial rating system and possibly have their accreditation lowered. The amount of fiscal impact would depend on how the information was used by each school district's constituents. School districts would have to prepare an annual financial management report and have a public meeting on the report. Senate Bill (SB) 218 of the 77<sup>th</sup> Legislature (2001) required the implementation of a transitional financial accountability rating system for school districts by August 2002.

#### Texas Education Agency Fiscal Tools

Financial Accountability has been a focus area due to legislation and commissioner rulings. These include the following fiscal tools:

The Financial Excellence Indicator System for Texas –Information about Educational Resources (FEISTIER) was launched through a partnership between Texas Association of School Business Officials (TASBO) and the Texas Education Agency (TEA) in 2000. FEISTIER provides five years of comprehensive audited financial data along with other related data needed for comparing and monitoring changes in financial and academic performance. This database is updated annually, and the functionality, analysis, and reporting components are reviewed and improved each year using feedback from users (<http://www.tbec.org/feistier.htm>, 2003).

The Financial Recovery Initiative for Texas public schools represented a concerted effort by the Texas Education Agency to identify the increasing number of

public and charter schools that are experiencing financial management difficulties. Also, it was intended to promote certain strategies to help those districts overcome their respective difficulties. Categories of FRI include the following: (1) Total staffing; (2) Total students; (3) Management and operating tax rate; and (4) Fund balance (<http://www.esc13.net/finance/>, 2003).

The Financial Integrity Rating System of Texas (FIRST) expanded the public education accountability system in Texas as a mandate in S.B. 218 (2001). It began as S.B. 875 during the 76<sup>th</sup> Legislative Session. Both TEA and the Comptroller of Public Accounts consulted on the proposal and forwarded the idea to the Legislature in December 2000. It is comprised of indicators at the district level similar to the current academic performance rating system (Appendix A). This rating system was an attempt to furnish fair and equitable evaluators of the quality of financial management decisions.

The primary objective of FIRST is to achieve quality performance in the management of school districts’ financial resources. This goal is significant due to the complexity of accounting associated with the Texas school finance system and the current funding crisis in public education.

School districts were classified into the following ratings under the FIRST model:

<b>Ratings</b>	<b>No Indicators</b>
Superior	0-2
Above Standard	3-4
Standard	5-6
Substandard	More than 6 or “No” in critical
Suspended – Data Quality	



Districts receiving either of the two latter ratings under this accountability system must file a corrective action plan with the Texas Education Agency.

Some of the twenty-one indicators included in the FIRST initiative include the following: (1) Declining enrollment; (2) Inappropriate staffing; (3) Changing Property Values; (4) Instruction spending percentages; (5) Internal controls; and (6) Fund balance percentages (<http://www.esc17.net/escweb/>, 2003).

The FIRST goals include: 1) achieving improved performance in the management of school districts' financial resources; 2) facilitating better uses of financial resources; and 3) demonstrating increased district financial performance. While the FIRST objectives attempt to: 1) assess the quality of financial management; 2) publicly report the rating; 3) assure the maximum allocation possible for direct instructional purposes; 4) implement a rating system that fairly and equitably evaluates the quality of financial management decisions.

The FIRST ratings began in the 2000 fiscal year. There were 874 school districts, which were 'superior'; 90 school districts above 'standard'; 5 school districts 'standard'; and 71 districts, which were 'substandard'. The potential consequence for a 'substandard' achievement rating could result in assignment of a Financial Monitor or Master to control finance (<http://www.esc17.net/escweb/download.01FIRST.ppt>).

#### *Fiscal Tools and the Decision Making Models*

The formulation of the fiscal tools of the Texas Education Agency are grounded in the rational decision making model. They utilize orderly and substantive decision-

making processes. Their focus is centered on efficiency and effectiveness. They optimize rules and standards.

In contrast, incrementalism employs a procedural process centered on the traditional methodologies characterized by stability and fairness. Finally, the garbage can model reflects inconsistent and pluralistic dimensions characterized by potential disagreements. Their use of data is haphazard and segmented.

### The Concept of Bankruptcy and Distress

For the purposes of this study, the term bankruptcy refers to the ability of a local governmental entity, such as a school district, to file for bankruptcy under the provisions of Chapter 9 of the Uniform Bankruptcy Act. Only 14 states permit filing Chapter 9 bankruptcy. They include: Alaska, California, Colorado, Connecticut, Idaho, Louisiana, Montana, Nebraska, New Jersey, New York, North Carolina, Pennsylvania, South Carolina and Texas.

The purpose of the original Bankruptcy Act of 1898, as well as the present code, is to allow a bankrupt debtor to discharge his debts and to provide for an equitable and timely distribution of the remaining assets to the creditors.

According to Wood (1985), there are three major impediments to the widespread use of Chapter 9 by school districts:

- (1) State law must authorize the filing of a Chapter 9 provision.
- (2) The municipality or school district must be insolvent at the time of filing.
- (3) The filing of a Chapter 9 provision makes any further public debt financing by the entity almost impossible.

Most generally accepted descriptors of fiscal distress that are available find their basis from the private as well as the public domain. The most recognized meaning associated with fiscal distress encompasses the execution of bankruptcy proceedings and the ensuing closing. Often, this phenomenon is most closely associated with events in the corporate world. Yet, it has not been uncommon to use it with events in the context of public schooling.

Murphy (1983), Berny (1982), and Lee (1983) defined fiscally distressed schools as districts which either closed, received emergency loans, or requested pre-closing audits. Miller (1994) cautioned that school finance is not a simple thing. District officials should begin to understand and recognize the manifestations of a financially ill school district. Symptoms included:

- (1) The district spends more than its income.
- (2) The district saves money by having a cheap annual audit.
- (3) The district overstates income and growth calculations.
- (4) The district is more than one year behind on accounts payable items.
- (5) The district does very few budget revisions.
- (6) The district has no control system for payroll expenditures.
- (7) The district has excessive multiyear union contracts with built in automatic increments.
- (8) The district continues to level up when the economy is leveling down.
- (9) The district practices expensive and unrealistic personnel practices.

- (10) The district does not monitor building projects, related income, and cash-flow sources.
- (11) The district under staffs the business office to save money.
- (12) The district fills an open certified business officer position with an extra principal to save money.
- (13) The district approves program endorsed by the superintendent and others because the programs are good for the students, despite excessive encroachment on the general fund (Miller, 1994).

Groves and Godsey (1980), Popernick (1987) in their works established the current or general fund balances as a valid indicator of a governmental unit's financial condition. These studies focused on fiscal crises in municipalities, given the similarity of the accounting formats for both municipal governments and school districts, changes in a district's fund balances might be a suitable definition to study school district financial distress.

Miller and McClure (1988) provided seven tools for reliable budget forecasts and seven ways to survive the forecast. The authors stated that to furnish reliable budget forecasts, it is important to do the following: (a) clarify the purpose of the forecast, (b) match the time frame of the forecast with the purpose, (c) be certain that basic data is correct, (d) specify any assumptions, (e) be consistent in calculations, (f) examine the data critically, and (g) recognize that forecasting requires insight and intuition.

The authors also stated that to survive the budget forecasts, it is important to do the following: (a) compare apples to apples, (2) identify the competitors for school

district resources, (c) obtain accurate enrollment data and teacher population trends, (d) identify trends in the local economy and local business climate, (e) clarify data on assessed value and markets, (f) understand current trends in the housing market, and (g) monitoring the collection structure to identify obsolete practices.

Swanson (1978) contended that school districts are accused of inefficiency but are not equipped to dispute the charge through analysis. The author argued that the school board should provide for this analysis by hiring an efficiency analyst who could rationally evaluate all of the alternatives and force the individuals competing for resources to do the same. This would identify differences in priorities among the activists. The efficiency analyst could then present the results to the board of education to make the final decision after assessing the various positions.

Walters (1997) claimed that school business administrators probably do not use financial ratios unless they have a background in accounting and, even then, probably do not use them in presentations to the school board or community. Walters presented the following five ratios, which he called stability ratios, which could be used to analyze school districts fiscal health.

$$(1) \frac{\text{Fund Balance}}{\text{Total Assets}}$$

$$(2) \frac{\text{Net Revenue}}{\text{Fund Balance}}$$

$$(3) \frac{\text{Fixed Assets}}{\text{Long Term Debt}}$$

$$(4) \frac{\text{Current Receivables}}{\text{Annual Revenue}} \quad \times 365 \text{ days}$$

(5) Payables X 365 days  
Expenditures

The ratio of fund balance to total assets can be computed for the general fund or any of the individual funds. This ratio shows what part of total assets is free and clear. The ratio of net revenue to fund balance indicates how current operations are affecting the fund balance. Net revenue is calculated by subtracting total expenditures from total revenues. The ratio of fixed assets to long-term debt reveals district ownership of physical facilities in contrast to that owned by bondholders or outside agencies. This ratio is less important in school finance. It is not likely that a school district would sell buildings to pay debts. The ratio of current receivables to annual revenues multiplied by 365 days is the receivable turnover rate, and it is desirable to have a very small number. This measures the rate at which receivables are collected. The ratio of payables to expenditures multiplied by 365 days is the payable turnover rate, and it is desirable to have a large number. This measures how long the entity has control over cash.

#### The Stability of Publicly Funded Institutions

The historical trends surrounding insolvency and bankruptcy speak to the debts of merchants and individuals. The complexity of modern society and the response of governments to those conditions appear to have created another category of debtors. The new category is that of government itself. The necessity of restructuring while continuing the functions of government becomes overriding. The principle that publicly funded institutions cannot become bankrupt because of the ability to generate taxes has been proven untrue. The failures of both municipalities and school systems are indication of a changing world. The failures also force the need for innovative economic thinking to

find alternatives when governmental failures seem overwhelming. All organizations are exposed to the conditions of scarcity.

### Predicting Fiscal Distress in the Corporate World

The ability of Texas educational leaders to detect school district distress is vital for fiscal and political well being in education. Corporate economics gives evidence that there exist techniques that would be helpful in predicting fiscal distress in school districts. Honsberger (1979) asserted that bankruptcy and fiscal distress do not occur overnight in the corporate world. There are numerous indicators or predictors of fiscal problems that are available. Horrigan (1965), Beaver (1966, 1968), Deakin (1972) and Edmister (1972) all conducted research that reinforced this contention by demonstrating how particular financial ratios and computations were accurate as predictors of financial difficulties in the private sector.

Beaver (1966) also examined financial ratios in the corporate world to predict failure relative to random prediction. He utilized thirty different ratios and classified them into six groupings. These included: cash flow, net income, debt to assets, liquid assets to total debt, liquid asset to current debt, and turnover ratio. His conclusions centered around the belief that cash flow to total debt ratio had the ability to correctly classify failed firms significantly better than random prediction. Beaver (1968) followed up with a second study in which he compared various liquid versus non-liquid asset ratios. He concluded that in this study non-liquid asset ratios predicted corporate failure significantly better than liquid asset measures. He also noted failed firms have lower inventory balances than non-failed firms.

Beaver's studies were replicated by Deakin (1972) using thirty-two failed companies matched to thirty-two non-failed companies of similar size and industrial classification. The researcher had to distinguish between the groups by selecting a collection of discriminating variables that measure characteristics on which the groups are expected to differ. Deakin used Beaver's ratios as his discriminating variables.

Edmister (1972) also concluded that the application of a discriminate function analysis (DFA) used previously could lead to highly accurate predictions of small business failure with up to three years lead time. This researcher used nineteen common accounting ratios and five prevailing methods of analysis in studying a random sample of forty-two statements submitted to the Small Business Administration over a fifteen year period. His goal was to develop a function that would predict between loss and non-loss borrowers.

#### Predicting Fiscal Distress in the Educational World

In his review of the literature, Wade (1987) noted that although discriminate function analysis had been proven accurate in predicting corporate failure, this tool had rarely been used by public entities, particularly K-12. One exception cited was the research done by Lee (1983) in which DFA was used in a study of 615 school districts in Ohio. He found three variables covering the categories of liquidity, commitments, and investment earnings to be discriminant. Lee developed a model from these three variables that successfully predicted 95% of the 38 schools, which met the states "fiscal distress" criteria.



Wade (1987) examined 24 pairs of Michigan school districts of similar characteristics matching school districts with deficits with school districts that were fiscally sound. He developed a model employing DFA, which was 100% accurate in predicting the deficit and non-deficit school districts within the sample population. Pertinent conclusions drawn from Wade's study included: (1) ratio analysis can predict fiscal distress two or more years in advance; (2) per pupil expenditures improve predictive formula's powers; and (3) district employment costs including wages and benefits significantly improve the power of the analysis.

The implementation of compliance with state mandated standards of accounting furnished the county offices with expanded authority over development and monitoring of school district budgets (Frazier, 1993). The process is still evolving. Frazier (1993) noted several weaknesses. These included: (1) the need for compatibility between district and state accounting and budgetary systems; (2) the failure to develop a "statistical trail"; and (3) the recognition that current indicators might not be timely predictors.

Peek (1994) studied financial statements from 86 school districts in the Capital Region of Northern California over a two-year period. She compared fifteen ratios for 20 school districts that had been identified by the state as financially troubled with 20 similar school districts in the Capital Region who had been determined by the researcher to be in a financially strong position.

Finkelstein (1994) investigated the spending patterns of 1,000 California School Districts during a four-year period. In regards to capital and debt-related expenses he

found significantly higher expenditures for long-term loan repayment for high school and elementary school districts in the distressed groupings. Finkelstein concluded that although cash reserves and district types are general indicators of fiscal distress, a consistent spending pattern could not be identified.

The inference that was made asserted that financial difficulties are a combination of interactions that go well beyond the amount of money spent in a particular year for goods and services in certain budget categories. The researcher must go beyond understanding the fiscal condition of a school district to a better understanding of management practices and the decision-making process to be successful in differentiating more and less financially stable school districts.

The possibility of using financial ratios as a tool for analyzing and predicting insolvency in California school districts was studied by Saul (1995). She compared a group of 39 school districts that had experienced bankruptcy and/or were assigned a negative or qualified certification with two control groups during a two-year period. Twenty-four financial ratios were created that paralleled ratios that have been used in private industry and/or public institutions. Each of these ratios was devised so that they could use data available in the California Financial Reports filed annually by all school districts with their County Office of Education. To predict group membership a school district was first evaluated using Saul's Discriminate Function. A district would be predicted to be in the Distressed or Not Distressed category depending on if its score was closer to either the insolvent group mean or the solvent group mean.

Manca (1997) conducted a qualitative study on three distinctive school districts that had been in receivership. The researcher sought to find those conditions, fiscal decisions, and changes in law that had helped the school districts regain fiscal solvency. The commonalities noted by the researcher were as follows: (1) financial problems were incremental; (2) some form of short-term debt was used to supplement cash flow; and (3) a receiver was appointed by the state to take over the administration of the district; (4) there was a lack of long-range financial planning; and (5) the superintendents did not demonstrate a clear understanding of the financial position of the districts.

#### Summary

This review of literature sought to furnish a conceptual foundation that would justify the purposes of this study. In summarizing the review of literature for this chapter it is evident that there have been numerous quantitative studies conducted on fiscal distress and the application of ratio analysis. Also, the historical background of Texas has been filled with both judicial and legislative decisions that have addressed political, legal and economic questions in terms of financial accountability.

Public schools continue to struggle with the problem of balancing ever-growing needs with limited sources of revenue. A question can be raised whether is this a dilemma due to forces outside of the educational realm, or is it due to poor management of district resources?

The financial accountability rating system instituted in Texas was designed to benefit the public by putting into place a system to ensure that school districts would be

held accountable for the quality of their financial management practices and achieve improved performance in the management of their financial resources.

## CHAPTER III: DESIGN AND METHODOLOGY

### Introduction

The purpose of this study is to understand the financial conditions and decision making protocols in two school districts which have been identified by a panel of experts as well as the Texas Education Agency data bases as having 'substandard' ratings, and as having recovered or are in the process of significant recovery from fiscal insolvency.

The following research questions were addressed:

- (1) What were the factors contributing to the districts' fiscal insolvency?
- (2) What were the factors contributing to the districts' regaining fiscal solvency?
- (3) Were the fiscal tools of the Texas Education Agency used in resolving the problem?

A qualitative case study approach will be used for this study. School finance is a very complex issue and any attempt to describe and understand the circumstances prior to the fiscal dilemmas of a given school district would demand an investigation using qualitative research methods. In that the school districts have made considerable progress toward regaining fiscal solvency this study could furnish baseline information and recommendations for other school districts having fiscal problems.

The design of this study was to utilize a multiple case study based on (a) the application of descriptive quantitative financial ratios for each case, (b) PEIMS data, (c) on-site semi structured interviews, and (d) a review of primary financial documents. The procedures that the researcher used to conduct the study were: (a) the selection of cases, (b) development of interview methodology, (c) field testing of interview questions, (d)

content analysis of documents, (e) data analysis, (f) assessment of validity and reliability, and (g) a summary. Multiple cases were chosen for several reasons. One of those reasons was to establish trustworthiness. The researcher was able to establish the strength of the emerging themes by discovering instances where common experiences occurred from one case to another. Miles and Huberman (1994) stated that even “stiffer cases can be made by looking at multiple cases: finding a pattern in a cross-case display, and then tracing carefully through all the cases to see whether the pattern is repeated”(p. 273).

### Conceptual Framework

Budgeting requires decision-making. The task in rational choice theory is to identify or discover the optimal choice for the outcome of decision, confronting a decision-maker. The decision maker simply collects information on the levels of the attributes of the alternatives, applies pre-existing values to those levels, applies the appropriate choice rule, and the superior option is revealed. A virtue of the theoretical framework of rational choice is that this paradigm identifies attention to the difference between the goals of the individual in terms of maximizing their own welfare and the professed goals of the organization. This theory furnishes a rational explanation for much of the behavior that otherwise appears irrational or pathological in terms of the expected outcomes of the decision.

There are a variety of decision-making modes. Both procedural uncertainty and goal ambiguity/conflict are contrasted in the following matrix:

		<u>GOAL AMBIGUITY/CONFLICT</u>	
		<u>Low</u>	<u>High</u>
<u>PROCEDURAL UNCERTAINTY</u>	<u>High</u>	<u>Rational mode</u> <ul style="list-style-type: none"> <li>• Goal-directed</li> <li>• Guided by rules, routines and performance programs</li> </ul>	<u>Political mode</u> <ul style="list-style-type: none"> <li>• Conflicting goals, interests</li> <li>• Certainty about preferred approach and outcomes</li> </ul>
	<u>Low</u>	<u>Process mode</u> <ul style="list-style-type: none"> <li>• Goal-directed</li> <li>• Multiple options and alternative solutions</li> </ul>	<u>Anarchy mode</u> <ul style="list-style-type: none"> <li>• Goals are ambiguous</li> <li>• Processes to reach goals are unclear.</li> </ul>

Source: <http://choo.fis.utoronto.ca/FIS/Courses/LIS2149/DM.models.htm>.

Complex decisions require structured decision processes. One approach to structured decision-making process is the Simon model (Figure 1).

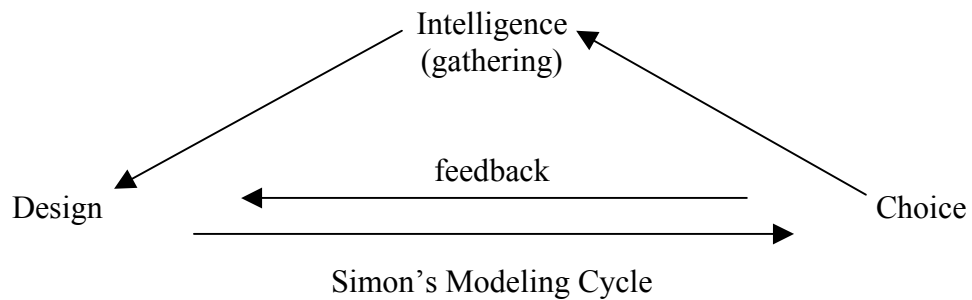


Figure 1

The rationalist Simon (1977) model for decision process is probably the most well known. It describes three main phases in the decision-making process: 1) Intelligence; 2) Design; and 3) Choice

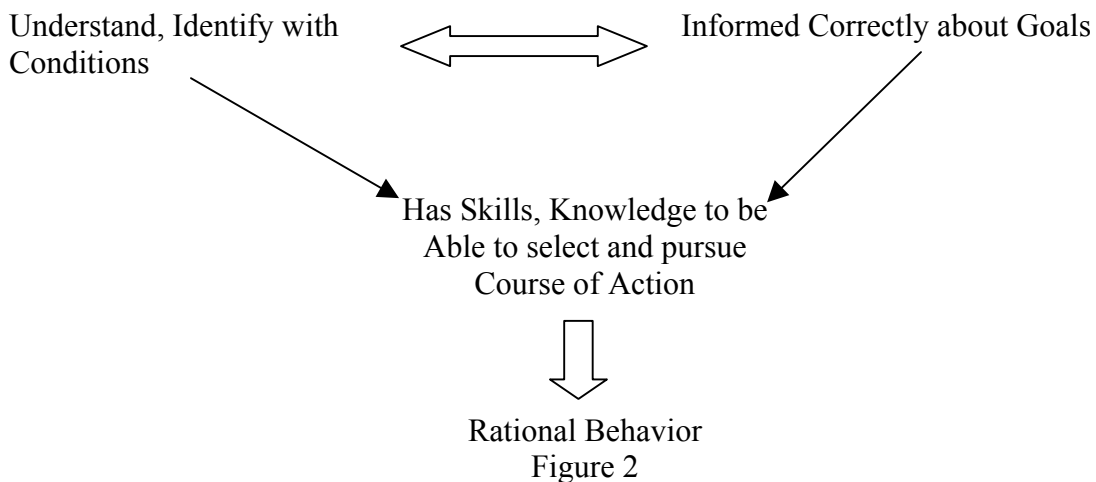
These phases are summarized as a set of steps as shown in Table 1.

Table 1: Steps in the phases of Simon’s Decision Process Cycle

Simon Phase	Steps to Follow
Intelligence (problem finding)	<ul style="list-style-type: none"> <li>• Gathering of data</li> <li>• Identifying objectives</li> <li>• Diagnosing problems</li> <li>• Validating data</li> </ul>
Design (develop alternatives)	<ul style="list-style-type: none"> <li>• Manipulate data</li> <li>• Quantify objectives</li> <li>• Generate reports</li> <li>• Generate alternatives</li> <li>• Assign risks or values to alternatives</li> </ul>
Choice (evaluate and select alternatives)	<ul style="list-style-type: none"> <li>• Generate statistics on alternatives</li> <li>• Explain alternatives</li> <li>• Choose among alternatives</li> <li>• Explain choice</li> </ul>

Source: Keen, P.G.W., & Morton, M.S., (1978). *Decision Support Systems: an organizational perspective*. Addison-Wesley.

Rational decision-making can be viewed through the following model (Figure 2).





The researcher believed that leadership in each school district would utilize the rational decision-making expressed in Figure 2 and Table 1. The theoretical framework furnished a backdrop to display the decision-making processes explored in this research study.

### Methodologies

In order to answer the questions that have been proposed the following mixed methodologies seem appropriate pragmatically and intuitively. Quantitative ratios and percentage changes were calculated to ensure the validity of the school districts' recovery and to present a rational approach to recovery recognition. Qualitative research was used to investigate the school districts through a more individual viewpoint. Interviews were held with the leading stakeholders in each district in order to gain perspectives of the participants.

### The Use of Qualitative Research

Qualitative research is multifaceted, involving an interpretive, naturalistic approach to its subject matter (Mertens, 1998). Qualitative research involves the use and collection of a variety of empirical methods – case study, personal experience, introspective, life story, interview, observational, historical, interactional, and visual texts – that describe routine and problematic moments and meanings in individuals' lives (Denzin & Lincoln, 1994, p. 2).

The data for this qualitative research study was collected in the following ways:

- (a) interviews,
- (b) observation,

(c) documents and artifacts.

In the 1970s, qualitative approaches, including case studies of the social life of schools and their participants began to appear (Merriam, 1995). Qualitative research can provide researchers with data for diagnosing and designing strategies to focus on organizational difficulties. The information generated can enable decision makers to design strategies for avoiding potential problems before they become serious difficulties (Herndon & Kreps, 1993).

The following characteristics of qualitative research methodology were identified by Taylor and Bogdan (1984).

- (1) Qualitative research is inductive.
- (2) The researcher looks at people and settings holistically.
- (3) Qualitative researchers are sensitive to their effects on the people they study.
- (4) Qualitative researchers try to understand people from their own frame of reference.
- (5) The qualitative researcher sets aside his or her beliefs, perspectives, and predispositions,
- (6) All perspectives are valuable for the qualitative researcher.
- (7) Qualitative methods are humanistic.
- (8) Qualitative researchers emphasize validity in their research.
- (9) For the qualitative researcher, all settings and people are worthy of study.

One of the most significant types of qualitative research can be found in case study research. Case study research is a description and analysis of an experience. The

object in a case study is to arrive at a holistic account and understanding. Some authors view the case study as one type of ethnographic (interpretive) research that involves intensive and detailed study of one individual or of a group as an entity, through observation, self-reports, and any other means (Langenbach, Vaughn, & Aagaard, 1994).

The case study method has been used across a variety of disciplines including law, medicine, psychology, sociology, and education. One of the characteristics of the case study approach is its adaptability to different research problems in many fields of study (Merriam & Simpson, 1995). Case study research uses many of the same techniques as historical research but it has two additional sources of evidence: direct observation and systematic interviewing.

There are four essential properties of a qualitative case study that were set forth by Merriam and Simpson (1995). Case studies are:

- (1) Particularistic. Case studies focus on a particular situation, event, program, and/or phenomenon.
- (2) Descriptive. The end product of a case study is a rich description of the phenomenon under study.
- (3) Heuristic. Case studies illuminate the reader's understanding of the phenomenon under study. They can bring about the discovery of new meaning, extend the reader's experience, or confirm what is known.
- (4) Inductive. Qualitative case studies for the most part rely upon inductive reasoning for the formulation of concepts, generalizations or tentative hypotheses.

## Selection of Cases

Conducting case studies requires certain data collection protocols. For instance to study a case, Stake (1994) recommends data collection of the following types of information:

- (1) The nature of the case
- (2) Its historical background
- (3) Other contexts, such as economic, political, legal, and aesthetic
- (4) Other cases through which this case is recognized
- (5) Those informants through whom the case can be known.

The cases selected for study also emerged from discussions with individuals knowledgeable in school finance. The researcher contacted Tom Canby (personal communication, June 18, 2003) of the Texas Education Agency Financial Audits, and Rita Chase (personal communication, June 26, 2003) of Texas Education Agency Accountability Division for suggestions of districts in Texas that had been classified as ‘substandard’ and have emerged or have made substantial progress toward fiscal improvement. Other documented communications with experts included Omar Garcia (Region XIII School Finance Specialist), Gwen Santiago (Executive Director of the Texas Association of School Business Officials), Catherine Clark (Texas Association of School Board Accountability Division and University of Texas at Austin finance professor), Jess Butler (former Eanes I.S.D. superintendent) and Ed Flathouse (former Texas Education Agency Deputy Associate Commissioner School Finance and Fiscal Analysis).

The researcher's committee suggested the model size of school district ranging from 3,000 to 8,000 students. Thus, my selection was narrowed and a request letter was mailed (Appendix B) to the following school districts' superintendents: Calhoun County ISD; Uvalde CISD; Lancaster ISD; Cedar Hill ISD; Zapata County ISD.

Cedar Hill ISD and Uvalde CISD were chosen because they met the criteria of: 1) the financial ratios; 2) the interest expressed by their respective superintendents; 3) improvement in TEA 'substandard' ratings in 2000-01; and 4) conversations and advice from various experts on school finance at the state and university faculty whom are familiar with Texas educational finance issues.

#### Interview Methodology

Protocol. In-depth interviews provided the format for data collection for this study of school districts that have successfully emerged from fiscal instability or have made substantial progress toward regaining fiscal solvency. Interviews were conducted in person at each of the school district sites: Cedar Hill, Texas and Uvalde, Texas. The participants interviewed for each case included the current school business official in each district; the current superintendent; and a representative of the Texas Education Agency overseeing the site.

The persons interviewed were contacted by phone to make arrangements for interview times and dates. Careful notes were taken at each interview and summaries of the notes were typed immediately. Also, each interview was tape-recorded with participant consent. Confidentiality was maintained by not naming the respondents in the study and the destruction of the audiotapes.

The questions asked in the interviews emerged from a review of the literature. They were designed to collect data from individuals who have special knowledge or perceptions that would not otherwise be available to the researcher. The first three questions were designed to establish that the person interviewed was a key informant and was qualified to speak to the problem. Questions 4 through 10 sought to gain information about the research questions. Interviews were semi-structured in nature in that the researcher asked structured questions and then probed more deeply using open-forum questions to obtain additional information. This process allowed the respondent to propose his/her own insights into the fiscal crisis and its resolution. In addition, sources of collaborative evidence or sources of information on prior history could emerge. The following structured interview questions were used:

- (1) What is your current position with the school district/state office and how long have you been in this position?
- (2) What are the major duties relative to fiscal decisions or financial oversight in your current job?
- (3) What changes, if any, have been made in your duties since you first took the position?
- (4) When did you first learn of the fiscal problems in the school district? What were the first indications of impending financial difficulties?
- (5) What were the circumstances immediately prior to a declaration of fiscal insolvency? In considering both revenue and expenditures for the school

district, was one side of the ledger more of a factor leading to the financial crisis?

- (6) Was error in predicting revenue or enrollment a contributing factor?
- (7) Did administrative decisions other than financial decisions negatively impact the financial condition of the district? Examples of such decisions might be curricular changes, staffing decisions, class size, or multi-year employee contracts.
- (8) What were the ramifications on the school district after the 'substandard' rating announcement? (learning environment/staff morale/public perception)
- (9) In your opinion, what were the key factors, which contributed to regaining fiscal solvency? (Possible factors could include changes in accounting procedures, additional staff in the business office, reduction in force, elimination of programs, multi-year budget planning, state mandated changes, better revenue forecasting) [Questions adapted from Manca, 1997]

Potential Probing Question: How were the Texas Education Agency fiscal tools (FEISTIER, FRI, and FIRST) used in resolving the problem?

#### Field Testing of Interview Questions

Trial interviews were conducted prior to the case study interviews in order to determine the appropriateness of the questions asked and to give the interviewer practice using the questioning strategies. The trial interviews were conducted in person with school business officials from districts not involved in the study, with a representative from the Texas Education Agency, and with a former superintendent of a large school

district in Central Texas. Slight modifications were made prior to conducting the actual interviews regarding the appropriateness of the questions to the study.

#### Content Analysis of Documents

The documents that the researcher obtained: (a) PEIMS data, (b) public records (school board minutes), (c) budget records and/or audit reports for each district, (d) financial reports to the Texas Education Agency or the Texas Comptroller of Public Accounts (e) organizational chart of each district, (f) job description of the school business official, (g) newspaper and journal articles, and (h) applicable state laws or commissioner rulings.

#### Treatment and Data Analysis

Interview data was compared with information from primary documents such as annual financial reports, audit reports, and reports to the Texas Education Agency, and financial reports made to the Texas Comptroller of Public Accounts Office. The content analysis of interview data was compared with an analysis of the primary documents including budget records, audit reports, minutes, agendas and PEIMS data. Inconsistencies and conflicts with interview information were noted and reported.

Data concerning the circumstances prior to a declaration of fiscal insolvency and during the period of ‘substandard’ rating was organized chronologically and presented in a descriptive format. The researcher analyzed factors mentioned as contributing to regaining a higher rating in an effort to identify those factors that may be shared by the districts studied. In addition, the contribution made by the Texas Education Agency fiscal tools toward resolving the problem was analyzed. Each case was presented and



discussed in a section of Chapter Four. Also, there is a section in Chapter Five covering cross-case analyses and summary resulting from all three sources of evidence.

### Validity and Reliability

A quantitative analysis was performed by the researcher through the application of four financial ratios to each district to support the reliability of the study. These financial ratios were developed by Saul (1996) in a study of 196 California school districts where she sought to identify the districts with possible financial adversity. Stepwise discriminate analysis from the four years of the study narrowed her original 24 ratios to 8. These were found to be significant in predicting the districts into solvent and insolvent groups. The function to predict the insolvent group was Wilks' Lambda of .833. Ratios 3, 13, 17, 22 were found to be the most appropriate components of the discriminate function. A more descriptive outline of each ratio is as follows:

R-3 – Reserve for Economic Uncertainties to Total Expenditures (including transfers out and other uses.

R-13 – Property tax as a percentage of total General Fund revenue.

R-17- Cash to current liabilities.

R-22- Benefits to total expenditures.

The School District Ratios were organized as follows:

	Source	FY 2000-01 %	FY 2001-02 %	FY 2002-03 %	Favorable Trend
R-3	School District Budgets			→	Increase
R-13	FIESTIER			→	Increase
R-17	Financial Audit			→	Increase
R-22	FIESTIER			→	Decrease

Additionally, case study research must meet four design tests including (a) construct validity; (b) internal validity; (c) external validity; and (d) reliability.

Yin (1994) has suggested various devices to meet each of these tests. Construct validity is the most problematic test in case study research. Using various sources of data and establishing a chain of evidence can help to guard against the allegation of subjectivity in data collection. Also, having key informants review a draft of the case study report for accuracy can help to avoid disapproval. In this study the researcher used several sources of evidence. These included structured interviews, audit reports, balance sheets for each district, financial reports to the state, school board minutes, and relevant local newspaper articles to establish a chain of evidence. Those persons interviewed for each case were furnished an opportunity to review a draft of the case study report.

External validity or the ability to generalize from the findings of the study has been a major criticism of case study research. Yin (1994) suggests the use of a multi-case research design in order to avoid this limitation. In this study, two totally independent cases have been selected for inclusion in a multi-case design to suggest a reasonable level of confidence that the findings can be generalized.

The use of a case study protocol and the development of a database for the case study are suggested by Yin (1994) to make certain that the researcher is in fact measuring the intended variables. Hence, the interview protocol for this multi-case study is presented above and is further enriched by the content analysis of primary documents for each case.

Case studies were reported in separate sections of Chapter Four for Cedar Hill Independent School District and Uvalde Consolidated Independent School District. Cross-case analyses, conclusions, implications, and recommendations are reported in Chapter Five.

#### Summary

The researcher has discussed the type of study and the kind of data that would be required to answer the research questions. There was discussion of the data collection and the analytical techniques employed by the researcher.

## CHAPTER IV: PRESENTATION AND ANALYSIS OF DATA

### Introduction

Chapter Four consists of three major sections. Each section presents the findings from a review of audit reports, budget documents, and financial reports, relevant newspaper articles, board minutes, correspondence, semi structured interviews with key informants, PEIMS data and financial ratios for each of the cases selected for inclusion in the study. The first section reports and analyzes the findings for the Cedar Hill Independent School District in Cedar Hill, Texas. Included in this section are: (a) descriptive financial ratios; (b) background information; (c) district mission statement; (d) historical summary; (e) expenditures; (f) organization plan; (g) on-site interviews including key factors for regaining fiscal solvency; and (h) summary.

The second section presents the findings for the Uvalde Consolidated Independent School District in Uvalde, Texas. Included in this section are: (a) descriptive financial ratios; (b) background information; (c) district mission statement; (d) historical summary; (e) expenditures; (f) organization plan; (g) on-site interviews including key factors to regaining fiscal solvency; and (h) summary.

#### Cedar Hill Independent School District

##### *Financial Ratios*

The researcher applied four financial ratios to the Cedar Hill ISD for FY 2000-01 to FY 2002-03 to support the question that the district has made progress toward achieving fiscal solvency. Saul (1996) developed the financial ratios in a study of 196 California school districts where she sought to identify the districts with possible

financial adversity. Stepwise discriminate analysis from the four years of the study narrowed her original 24 ratios to 8 that were found to be significant in predicting the districts into solvent and insolvent groups. Ratios 17, 22, 13, and 3 were found to be the most appropriate components of the discriminate function. The ratios used were R-3, Reserve for Economic Uncertainties. An increase in the ratios of Reserves for Economic Uncertainties to Total Expenditures would predict that the district would fall into a solvent group. The researcher substituted the Ending Fund Balance in the General Fund for the Reserve for Economic Uncertainties since the Ending Fund Balance in Texas is a school district's reserve for the subsequent year or years. When compared to the Total Expenditures will measure the ability of a district to handle fiscal emergencies. The Fund Balance is considered to be important enough to be a leading indicator in the TEA School FIRST Worksheet. The document states: "Was Total Fund Balance Less Reserved Fund Balance Greater than Zero in the General Fund?" (School First Rating Worksheet, p.69). For base fiscal year 2000-01 the district's ending fund balance were -\$2,727,529, so the ratio ends up being  $-\$2,727,529/\$36,361,719$  or 0 (From TEA FDA 05(S) report). For the FY 2001-02 the district's ending fund balance was -\$1,061,422. The ratio was  $-\$1,061,422/\$43,222,518$  or 0. For the FY 2002-03 the district's ending fund balance rose to \$881,077. The ratio became  $\$881,077/\$48,815,809$  or .0180. According to Dr. Maureen Saul's research on school districts in California, an increase in the Reserve for Economic Uncertainties would predict that a given school district is more solvent. The ratio in this district has gradually increased.

The second ratio applied to the Cedar Hill ISD was R-13, Property Tax as a Percentage of Total General Fund Revenue. An increase in this ratio would indicate placement of a school district into the more solvent group. For the base fiscal year 2000-01 is  $\$18,380,708/\$33,710,895$  or .5452. For the FY 2001-02, the ratio was  $\$23,687,354/\$43,243,639$  or .5477. For the FY 2002-03, the ratio was  $\$28,530,600/\$48,017,369$  or .5941. The trend in the ratios appears to be increasing. This overall increase according to Saul (1996) would also indicate placement of Cedar Hill ISD toward the solvent group.

The third ratio applied to the Cedar Hill ISD was R-17, Cash to Current Liabilities. For the base fiscal year 2000-01, the ratio was  $\$12,049,091/6,192,785$  or 1.9456. For the FY 2001-02, the ratio was  $\$25,493,005/\$9,214,620$  or 2.7665. For the FY 2002-03, the ratio was  $\$13,541,302/\$8,654,168$  or 1.5647. An increase in this ratio would indicate the placement of the Cedar Hill ISD toward the solvent group. This particular ratio fluctuated up and down and would not indicate a positive trend for the school district.

The fourth ratio that was applied to the school district was R-22, Benefits to Total Expenditures. For the base fiscal year of 2000-01, the ratio of Benefits to Total Expenditures was  $\$2,556,043/\$36,361,719$  or .070. For FY 2001-02, the ratio became  $\$3,193,264/\$43,222,518$  or .073. For FY 2002-03, the ratio of Benefits to Total Expenditures was  $\$3,732,007/\$48,815,809$  or .076. For this particular ratio a decrease indicates placement in the solvent group. For the last three years, the trend appears to be increasing, which would place the Cedar Hill ISD toward the insolvent group. The

results of the application of the four financial ratios to the Cedar Hill ISD are provided in Table 2.

Table 2. Cedar Hill ISD Ratios

	FY 2000-01	FY 2001-02	FY 2002-03
R-3	0	0	0.018
R-13	0.545	0.547	0.594
R-17	1.945	2.766	1.564
R-22	.070	.073	.076

R-3 – Reserve for Economic Uncertainties to Total Expenditures

R-13 – Property tax as a percentage of total General Fund revenue.

R-17 – Cash to current liabilities.

R-22 – Benefits to total expenditures.

The trend of the first ratio, R-3 or Reserve for Economic Uncertainties, increased numerical from FY 2000-01 on. This increasing trend is an indication of improved solvency. The second ratio, R-13 or Property Tax as a Percentage of Total General Fund Revenue shows an overall increase. This increasing trend would also indicate improved solvency. The third ratio, R-17 or Cash to Current Liabilities fluctuated giving no definitive trend or clear indication of improved solvency. The fourth ratio, R-22 or Benefits to Total Expenditures, would need to show a decreasing trend to indicate improved solvency. The results of this ratio project the contrary.

*Background Information*

The Cedar Hill Independent School District is located in southwestern Dallas County. It is classified by University Interscholastic League (UIL) as a 5A School, which means it has a student enrollment of 1,925 and up. The district delivers educational services to 7,554 students from pre-kindergarten through grade 12. It serves an area of 41.9 square miles with the majority of the school district in Dallas County. It

is located approximately 18 miles southwest of Dallas, Texas. This school district has 6 elementary schools (PK-4), 3 Intermediate (5-6), 1 Middle School (7-8), and 1 High School (9-12). As of the 2003-04 School Year the district's student ethnic diversity was 55 percent African American, 25 percent White, 17 percent Hispanic, and 3 percent Other (Cedar Hill I.S.D., State of the School District brochure, November, 2003).

Exhibit 4-1 details the enrollment and demographic characteristics of Cedar Hill ISD, its neighboring peer districts, Regional Education Service Center X (Region 10) and the state.

Exhibit 4-1  
Student Enrollment and Demographics  
Cedar Hill ISD, Peer Districts, Region 10 and State  
2002-03

District	Student Enrollment	% African Americans	% Hispanic	% White	% Asian/Pacific Islander	% Native American	% Economically Disadvantaged
<b>CHISD</b>	<b>7,331</b>	<b>52</b>	<b>16</b>	<b>30</b>	<b>2</b>	<b>0.5</b>	<b>26</b>
De Soto	7,584	66	12	20	1	0.2	34
Duncanville	10,930	43	29	25	3	0.2	46
Grand Prairie	21,554	15	52	28	4	0.8	59
<b>Region 10</b>	<b>635,621</b>	<b>21</b>	<b>33</b>	<b>41</b>	<b>5</b>	<b>0.5</b>	<b>45</b>
<b>State</b>	<b>4,239,911</b>	<b>14</b>	<b>43</b>	<b>40</b>	<b>3</b>	<b>0.3</b>	<b>52</b>

Source: Texas Education Agency (TEA); Public Education Information Management System (PEIMS), 2003-04.

Note: Totals may not add to 100 due to rounding.

CHISD has less business and more residential property value than the state, all but one peer district and regional averages (Exhibit 4-2). The higher percentage of residential value for CHISD indicates that local residents carry most of the local property tax burden to fund school operations. Land accounts for more than 7.2 percent of CHISD's property value, a percent that is higher than any of its peers, regional and state



averages. The higher land value indicates the potential for continued property development growth in CHISD.

Exhibit 4-2  
CHISD, Region 10, State and Peer District Property Values by Category  
as a Percentage of Total Property Value  
2002-03

District	% Business	% Residential	% Land	% Oil and Gas	% Other
De Soto	14.4	81.1	3.3	0.0	1.1
<b>Cedar Hill</b>	<b>20.7</b>	<b>72.1</b>	<b>7.2</b>	<b>0.0</b>	<b>0.0</b>
Grand Prairie	34.4	61.4	2.8	0.0	0.8
Duncanville	35	62.2	2.3	0.0	0.5
<b>Region 10</b>	<b>38.1</b>	<b>57.1</b>	<b>4.3</b>	<b>0.1</b>	<b>0.6</b>
<b>State</b>	<b>36.3</b>	<b>52.2</b>	<b>6.7</b>	<b>3.5</b>	<b>1.2</b>

Source: Texas Education Agency (TEA), Academic Excellence Indicator System (AEIS), 2002-03

In 2002-03, Texas school districts budgeted an average of 51.9 percent of their funds from the local property tax and 40.5 percent in revenue from the state (Exhibit 4-3). In CHISD, those percentages are 59.4 and 34.4 percent, respectively. The averages for the region are 65.5 and 27.2 percent, respectively. Since state funding is based on per student property values, the comparisons indicate that CHISD values per student are higher than the region while lower than the state average.

Exhibit 4-3  
CHISD, Region 10, State and Peer District  
Sources of Budgeted Revenue as a Percentage of Total Budgeted Revenue  
2002-03

Entity	Local Property Tax %	Other Local and Intermediate %	State %	Federal %
Duncanville	59.6	4.7	33.4	2.3
<b>Cedar Hill</b>	<b>59.4</b>	<b>4.4</b>	<b>34.4</b>	<b>1.8</b>
De Soto	51.2	3.7	43.0	2.1
Grand Prairie	39.0	3.9	56.9	0.2
<b>Region 10</b>	<b>65.5</b>	<b>5.4</b>	<b>27.2</b>	<b>1.9</b>
<b>State</b>	<b>51.9</b>	<b>4.2</b>	<b>40.5</b>	<b>3.5</b>

Source: TEA, AEIS, 2002-03

The state assigns funds for school program costs based on property values per student. CHISD’s developmental industrial growth and the corresponding increase in property values have caused an increase in the proportionate funding of program costs from local property taxes. From 1997-98 through 2002-03, local revenue as a percentage of total funding for CHISD increased by 48.5 percent. At the same time, state revenue as a percentage of total funding decreased by 34.2 percent (Exhibit 4-4).

Exhibit 4-4  
CHISD Sources of Revenue as a Percentage of Total Revenue  
1997-98 through 2001-02

Source of Revenue	1997-98 %	1998-99 %	1999- 2000 %	2000-01 %	2001-02 %	2002-03 %	Percentage Change 1997- 98 to 2002-03
Local Property Tax	40.0	45.8	43.6	54.5	54.8	59.4	48.5
Other local and intermediate	5.8	5.7	4.6	4.9	6.0	4.4	(2.4)
State	52.3	46.7	50.2	38.6	37.4	34.4	(34.2)
Federal	1.9	1.8	1.6	2.0	1.8	1.8	(0.5)

Source: TEA, Public Education Information Management System (PEIMS),  
1997-98 through 2002-03

*District Mission Statement*

The Mission Statement of the district states that “with the partnership of parents and cooperation with the community, the school district will educate and produce graduates who are fully enabled to successfully engage as responsible and contributing members of our rapidly changing society” (Cedar Hill I.S.D., State of the School District brochure, November, 2003). The four-year high school completion rate for the Cedar Hill Independent School District is approximately 90 percent. This is accomplished with a total district budget of approximately \$49 million for the 2003-04 year.

In August 2003, CHISD's adopted tax rate was \$1.61 (\$1.43 maintenance and operations plus \$.17 debt service) after a series of increases and decreases from the 1996-97 adopted tax rate of \$1.89 (\$1.35 maintenance and operations plus \$0.54 debt service). At the same time, CHISD's property value reached \$238,032 per student, compared to the state average of \$242,809 per student.

Exhibit 4-5  
Cedar Hill ISD Comptroller Tax Rates, Assessed Property Values  
And Per Student Property Values  
1996-97 through 2002-03

Category	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	Percentage Change
Maintenance and Operations tax rate	\$1.35	\$1.28	\$1.45	\$1.31	\$1.43	\$1.43	\$1.50	11
Interest and Sinking fund tax rate	\$0.54	\$0.48	\$0.33	\$0.32	\$0.20	\$0.19	\$0.18	(66.6)
Total Tax Rate	\$1.89	\$1.76	\$1.78	\$1.63	\$1.63	\$1.62	\$1.68	11
Total Property Value (000s)	\$774,628	\$864,911	\$953,482	\$1,117,885	\$1,268,085	\$1,532,292	\$1,745,011	12.5
Total Students	5,806	6,073	6,144	6,173	6,481	6,702	6,922	19
Value per student	\$133,419	\$142,419	\$155,189	\$181,093	\$195,662	\$220,760	\$238,032	10.4

Source: TEA, Academic Excellence Indicator System (AEIS), 1996-97 through 2002-03.

### *Expenditures*

On the expenditure side, Exhibit 4-6 shows how CHISD distributed budgeted funds in 2002-03 compared to the state average. Of particular significance is CHISD's allocation to the instructional category, which is higher than the state average.

Exhibit 4-6  
 CHISD and State Total Budgeted Expenditures by Function as a Percentage of Total  
 Budgeted Expenditures  
 2002-03

Function	CHISD	Percentage Spent	State	Percentage Spent
Instruction (11,95)	\$25,599,198	61.0	\$15,258,107,372	57.0
Instructional-Related Services (12,13)	\$1,145,499	2.7	\$815,176,913	3.0
Instructional Leadership (21)	\$535,740	1.3	\$360,073,948	1.3
School Leadership (23)	\$2,397,189	5.7	\$1,588,708,640	5.9
Support Services-Student (31,32,33)	\$1,520,459	3.6	\$1,204,538,130	4.5
Student Transportation (34)	\$210,000	0.5	\$788,729,993	2.9
Food Services (35)	\$2,011,033	4.8	\$1,470,996,886	5.5
Co-curricular/Extracurricular Activities (36)	\$1,265,514	3.0	\$682,584,402	2.5
Central Administration (41)	\$1,683,074	4.0	\$1,090,220,713	4.1
Plant Maintenance & Operations (51)	\$4,764,450	11.4	\$2,995,707,896	11.2
Security & Monitoring Services (52)	\$327,800	0.8	\$181,806,687	0.7
Data Processing Services (53)	\$513,483	1.2	\$348,481,432	1.3
Total Budgeted Expenditures	\$41,973,439	100.0	\$26,785,133,012	100.0

Source: TEA, PEIMS, 2002-03.

A longitudinal presentation of expenditures for the school district is presented in Exhibit 4-7. There were increases in all expenditures function areas during this timeframe. The largest increases occurred in Security and Monitoring Services (276.8 percent); Student Transportation (228.1 percent); and Instructional Leadership (206.3 percent). In comparison, the state averages increased in each function by 125.6 percent; 54.2% and 37.8% respectively.

Exhibit 4-7  
A Longitudinal Presentation of CHISD Budgeted Expenditures by Function  
FY 1996-2002

Function	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	Percent Change
Instruction (11,95)	\$13,702,781	\$16,575,110	\$17,581,013	\$20,008,482	\$21,717,447	\$22,660,417	25,599,198	86.8
Instructional-Related Services (12,13)	\$789,839	\$898,393	\$904,718	\$872,311	\$1,101,054	\$1,174,908	\$1,145,499	45.0
Instructional Leadership (21)	\$174,907	\$171,327	\$323,916	\$398,963	\$454,853	\$449,791	\$535,740	<b>206.3</b>
School Leadership (23)	\$1,136,085	\$1,394,490	\$1,451,741	\$1,535,312	\$1,788,992	\$1,896,436	\$2,397,189	111.0
Support Services-Student (31,32,33)	\$948,980	\$1,28,063	\$1,227,534	\$1,323,818	\$1,402,147	\$1,555,004	\$1,520,459	60.2
Student Transportation (34)	\$64,000	\$87,600	\$2,275	\$41,422	\$166,570	\$207,875	\$210,000	<b>228.1</b>
Food Services (35)	\$1,202,959	\$1,273,497	\$757,750	\$1,576,450	\$1,733,908	\$1,857,635	\$2,011,033	67.2
Co-curricular/ Extracurricular Activities (36)	\$719,067	\$782,648	\$774,094	\$963,997	\$955,757	\$767,448	\$1,265,534	76.0
Central Administration (41)	\$946,086	\$1,104,588	\$967,959	\$1,171,788	\$1,312,893	\$1,344,920	\$1,683,074	77.9
Plant Maintenance & Operations (51)	\$2,778,459	\$3,409,228	\$3,396,100	\$3,582,205	\$4,221,095	\$4,473,381	\$4,764,450	71.5
Security & Monitoring Services (52)	\$87,000	\$97,500	\$107,000	\$99,310	\$122,200	\$135,822	\$327,800	<b>276.8</b>
Data Processing Services (53)	\$155,377	\$192,174	\$263,157	\$325,502	\$344,427	\$409,421	\$327,800	111.0
Total Budgeted Expenditures	\$23,705,540	\$27,114,618	\$27,759,257	\$31,899,560	\$35,321,348	\$36,933,078	\$41,973,439	77.1

Source: TEA, PEIMS FY1996-FY2002

On a per student basis from 1997-98 to 2002-03, CHISD's expenditures have increased 42.5 percent (Exhibit 4-8). Instruction and instructional leadership spending has increased 29.2 percent, or \$807, per student while school leadership spending has increased 42.1 percent, or \$97, per student. The large increase in non-operations costs results from the inclusion of debt service for 2001-2003, while excluded in other years.

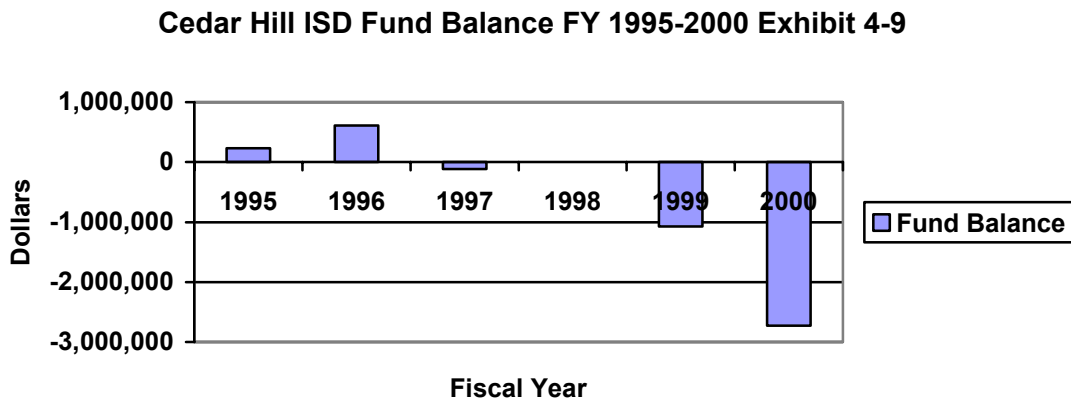
Exhibit 4-8  
CHISD Expenditures per Student  
1997-98 through 2002-03

Expenditure Category	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	Percentage Change
Instruction and Instructional Leadership	\$2,758	\$2,914	\$3,306	\$3,421	\$3,318	\$3,565	29.2
School Leadership	\$230	\$236	\$249	\$276	\$272	\$327	42.1
Central Administration	\$182	\$158	\$190	\$203	\$193	\$230	26.3
Other operating	\$1,295	\$1,210	\$1,423	\$1,550	\$1,552	\$1,604	23.8
<b>Total operations</b>	<b>\$4,465</b>	<b>\$4,518</b>	<b>\$5,168</b>	<b>\$5,450</b>	<b>\$5,335</b>	<b>\$5,725</b>	<b>28.2</b>
<b>Total non-operations</b>	<b>\$207</b>	<b>\$233</b>	<b>\$170</b>	<b>\$161</b>	<b>\$870</b>	<b>\$983</b>	<b>374.8</b>
<b>Total per student</b>	<b>\$4,672</b>	<b>\$4,751</b>	<b>\$5,338</b>	<b>\$5,611</b>	<b>\$6,205</b>	<b>\$6,659</b>	<b>42.5</b>

Source: TEA, PEIMS, 1997-98 through 2002-03

*Historical Summary*

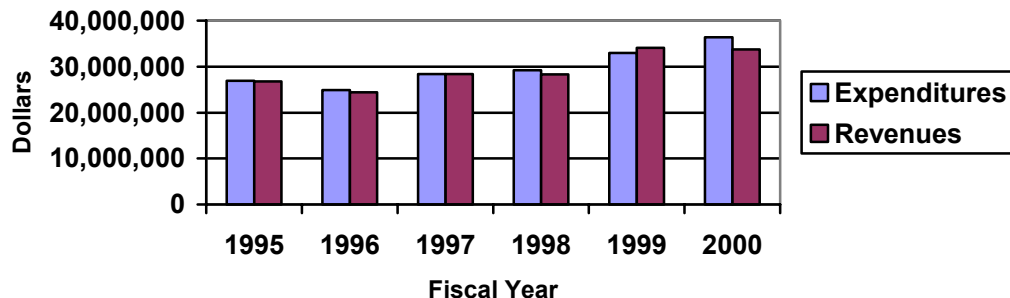
The fiscal crisis of the Cedar Hill Independent School District stemmed from several problems that became more severe between FY 2000-01 and FY 2001-02. During this time frame district salaries increased by 4% at the mid-point and district health benefits costs increased by 91.4%. The district was also experiencing a negative fund balance, which it had experienced since 1994-95 (Appendix C). A visual depiction of the situation can be viewed in Exhibit 4-8.



Source: TEA, PEIMS, FY 1995-2000

An investigation of the relationship between expenditures and revenue could serve as a prelude to the crisis (Exhibit 4-10).

**Cedar Hill ISD Expenditures/Revenues FY 1995-2000**  
**Exhibit 4-10**



Source: TEA, PEIMS, FY 1995-2000

Expenditures had exceeded revenues in both FY 2000-01 and FY 2002-03(Appendix B).

The financial problems of Cedar Hill Independent School District were serious, yet incremental. The TEA issued a ‘substandard achievement’ rating to the school district because of failure for indicator 1 and 18. Both of these indicators dealt with negative fund balance and insufficient total fund balance (Appendix C). The instrument is designed to rate a district in the ‘substandard achievement’ category if it answers NO to indicator 1. In February 2002, the Comptroller announced her decision to review the Cedar Hill Independent School District through a Texas School Performance Review (TSPR).

The district experienced student growth as well as increases in total staff in a ten-year period. The enrollment of the district grew from 5,279 (1994-95) to 7,331 (2002-03), which accounted for a 38.9 percent increase. While total staff increases included 548 (1994-95) to 899 (2002-03) that reflected a 64 percent increase. The non-teaching

staff increases were the driving change and cost during this timeframe. Furthermore, the school district pupil/teacher ratio had grown from 14.9 (2000-01) to 15.7 (2002-03).

Table 1  
Cedar Hill ISD  
Student Enrollment – Professional Employees/Total Staff

Year	Enrollment	Professional Employees/Total Staff	%Ratio of Total Staff/Enrollment	%Ratio of Employees/Total Staff
1993-94	5,057	355/547	9.24	64.9
1994-95	5,279	369/548	9.63	67.3
1995-96	5,615	398/591	9.50	67.3
1996-97	5,806	432/658	8.82	65.6
1997-98	6,073	472/725	8.37	65.1
1998-99	6,144	485/769	7.98	63.0
1999-2000	6,173	497/784	7.87	63.4
2000-01	6,481	515/805	8.05	63.9
2001-02	6,941	535/856	8.10	62.5
2002-03	7,331	568/899	8.15	63.1

Source: TEA, PEIMS, 1993-94 through 2002-03

The ratio of employees to total staff had grown 2.7 percent, which could be explained with the growth the number of campuses throughout the district. While the ratio of total staff to enrollment decreased by 11.8 percent during this timeframe. This ratio of total staff to enrollment despite the decrease fell within the standards of the FIRST indicator #17 for a school district of this size.

#### *Organizational Plan*

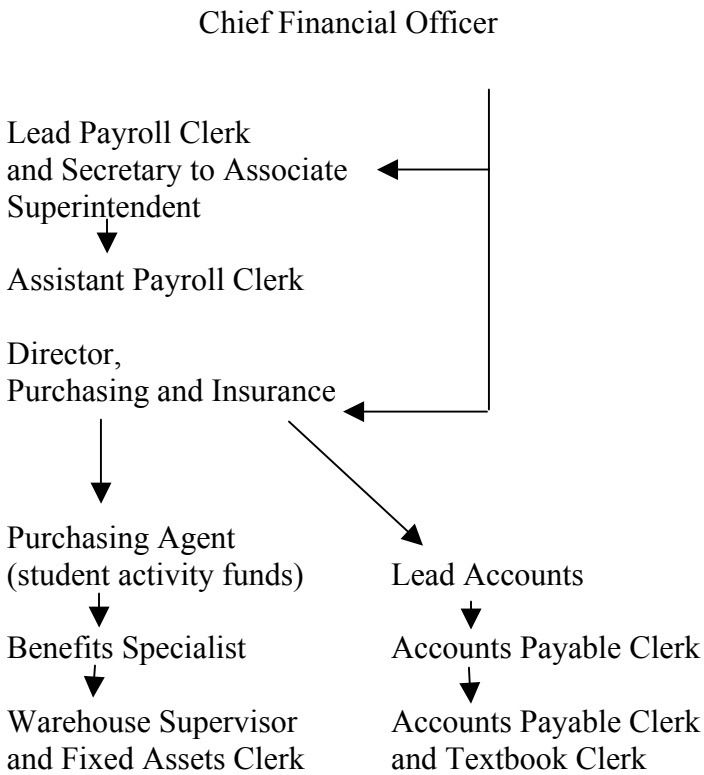
The Cedar Hill Independent School Board instituted goals which included the following targets: 1) Achieve a fund balance of 10 percent by the close of 2004 and 15 percent by close of 2007 (Cedar Hill Independent Board Minutes, August 26, 2003). Other board priorities included raising or improving the underlying bond ratings from BBB+ by 2005-06. Also, a changing of the Fiscal Year (July 1- June 30) was adopted to better align with Federal funding (Cedar Hill Independent Board Minutes, February 9,



2004). The Board approved the purchase of the Skyward PC Finance and Student System on April 14, 2003 (Cedar Hill Independent School District Board Minutes). Finally, there was a reorganization of CHISD Business and Support Services to better assist in internal transactions (Exhibit 4-11).

The creation of the CHISD’s Chief Financial Officer position realigned the responsible for budget and finance, payroll and employee benefits. The Associate Superintendent, Business and Support Services had previously administered this position. After the reorganization, the Associate Superintendent was taken out of the finance area and placed solely in operations.

Exhibit 4-11  
 Organization of CHISD Business and Support Services  
 2002-03



Source: CHISD Chief Financial Officer.

The next section contains interviews with several leading stakeholders that were critical in terms of understanding the fiscal decision-making within this school district.

#### On-Site Interviews

On June 1, 2004, the researcher traveled to Cedar Hill, Texas to interview the following individuals: superintendent (S. #1) who served the district for the last three years and was hired in June 2001; chief financial officer (CFO) who had been in that position since September 2002; and the school board president (S.B.P. #1) who was finishing her second year as president and was first elected to the board in 1994. The TEA Representative was interviewed in Austin, Texas on June 15, 2004.

#### *Analysis*

The Cedar Hill Independent School District experienced a period of time where the political process determined many of the budgetary decisions.

“Board members are no longer here; rightly or wrongly. I don’t believe that they were personally responsible but they were held personally responsible and when the State Comptroller’s office came in and made such a big to do about it people in the community snapped up on that. They got the blame. I didn’t and I’ve been here in the same capacity they were. So why that happened to them; it was just the timing; they were definitely held accountable” (S.B.P. #1, 2004).

Despite growing enrollments and revenues the district continued to experience budget deficits. “I don’t believe that it was because I believe that the numbers came in consistently higher. They saw the growth and they knew what was happening and let’s just spend, spend, and spend” (CFO, 2004). Also, “I can remember a time years ago when it was wouldn’t that be nice if we could do that oh no, let’s spend it on something else” (S.B.P. #1, 2004). The administrative team was attempting to handle the hard

economic decisions with unclear goals, unclear technology and fluid participants.

Furthermore, there was an absence of communication regarding the ramifications of the negative fund balances.

The new superintendent addressed the crisis by implementing rational approaches to budgeting. He instituted common rational reforms to the budget including both program budgeting and long-term strategic choices on expenditure levels compared to annual periodicity.

“We have adopted a practice (first year I came here) the board considered and approved revenue assumptions early on to guide the staff in developing on the revenue side. Similarly, we have been considering expenditure assumptions. But, we take assumptions and use that to project out at least one year and sometimes two” (S. #1, 2004).

Yet, the researcher is alarmed at the comment of, “the superintendent and I have publicly stated that our budget philosophy is to underestimate revenue and overestimate expenditures” (CFO, 2004). This type of mentality could promote distrust by policymakers of school officials. A more sound practice would entail making accurate estimates using accurate data.

The superintendent demonstrated leadership by clearly identifying and communicating to his board the direction the district must pursue in order to become economically viable. The board’s transformation was described as follows:

“I saw a big difference in the board in terms of their attitude in regards to the fund balance. It had no importance then it got a little important then it got real important. It changed so much with the personalities on the board and with the influence of the superintendent (S.B.P. #1, 2004).

The district utilized the TEA tools as both resources and guidance. Yet, their major influences in solving the fiscal problems of the district appeared to be in terms of outside

consultants, improved computer software and the Comptroller's (2002) report. All of which more closely follow the rational decision-making model.

### *Thematic Responses*

The respondent's answers are organized by research question themes to furnish the reader more insight into pre and post crisis period for the school district.

### *Major Financial Duties*

**Interviewer:** What are the major duties relative to fiscal decisions or financial oversight in current job?

**S. #1:** Making budgetary recommendations to the school board both relative to budget and well as tax rates. Also, in terms of budgeting, I provide the supervision of the chief financial officer.

**CFO:** The actual departments that I supervise are the Payroll Department, the Purchasing Department, the Accounts Payable, the Accounts Receivable, and all other budgetary aspects. Basically, I do all the forecasting of the revenue, setting up the budget and I am the designee of the superintendent and I together with him set that budget. You put all those players and pieces together. There are lots of little things that I sort of forget about from day to day. The big portion is the investment; I am the investment officer of the school district.

**S.B.P. #1:** Well, technically the board approves the budget.

### *Awareness of the Fiscal Problems of the District*

**Interviewer:** When did you first learn of the fiscal problems in the school district?

**S. #1:** As I contemplated making application I was aware of a history of negative fund balances. I would say that they became most apparent when the comptroller's office expressed their concern.

**CFO:** Well, I have some great resources with TEA and confidants that are always very open with me. The first thing I do if I am looking for a position I call up the snapshot date it tells me a lot of things I need to know. The snapshot told me they had a negative fund balance and as I went back it told me that they had a negative fund balance for numerous years. That tells me right there that is a "red flag." I am not afraid of a "red flag." In fact, I would prefer to go to a district that has financial problems and be in a district in which they already had done everything correctly. Between the snapshot, the TEA public information website and some resources that I had been checking I knew that Cedar Hill had some problems. But they have some great advantages. Cedar Hill had hope. They had hope in the sense that they have an increasing tax base here and increasing kids.

**S.B.P. #1:** Well, it isn't like a light clicked on and there was a problem. There was a growing problem there is always a situation a changing situation of what the state legislature decides. What the amount of state aid, the formula all of that changes constantly. So it didn't all happen all in one day. I would say it has been an ongoing process my entire term. The fund deficit situation that is more recent. That evolved also. I became most aware of it a year or two before the current superintendent came probably in 1999.

*Circumstances Prior to the Period of Fiscal Insolvency*

**Interviewer:** What were the circumstances immediately prior to the ‘substandard’ rating?

**S. #1:** What I have been told in general was that administration would take budget recommendations to the school board. School board members, individually and understandably and predictably would express concern about needed program reduction. Administration would go back and come back with projected revenue necessary to cover the program costs, the needed reductions. When I arrived there were some excess staff members primarily at the high school and consequently more the first year were coming through at the high school at about 6 percent.

**CFO:** I don’t know the history. I hear people talk and see the facts. We as administrators knew what the revenue and the expenditures were. They consistently out extended their revenues. It wasn’t the on the revenue side; we did not miscalculated enrollment or tax base. None of these were the case...it was that they consistently outspent their revenues. You can’t do that consistently. I think it was just a matter of never telling anybody “No”. Nobody wanted to make the tough decision to do that. I’m sorry not today; not going to happen today. They didn’t seem to have a clear philosophy. Not able to say no but there was not vision. Doctor and I have a plan that puts us with a savings account that fills up every year. It fills up every year because we force it to fill up. There isn’t; I don’t know if there was always that philosophy. My school board can

hold me accountable...you gave me this handout that said this is how you were creating a savings account. If there isn't a savings account at the end of the year then predictions were incorrect or did we spend the money? Number one, we can't spend the money because we didn't budget to spend the money. The only thing that can fall apart, some part of the piggy bank plan didn't fall into place. It is so conservative that it has to happen. A real philosophy; it is pretty much how you run your household.

**S.B.P. #1:** We are not in this business to make money so the money comes in and goes out. A few little glitches here or there can make a big difference. I guess the fund balance is the barometer of how well your district is doing...and it did all of the sudden go way down.

#### *Contributing Factors*

**Interviewer:** Was error in predicting revenue or enrollment a contributing factor?

**S. #1:** The best of my knowledge...it was on the revenue side.

**CFO:** I don't believe that it was because I believe that the numbers came in consistently higher. They saw the growth and they knew what was happening and let's just spend, spend, and spend. Well, you can't out spend and you have to plan accordingly because it is really easy to let different factions spend and we don't ever say no.

**S.B.P. #1:** Well, I think that it is common sense that if your expenses aren't as great then you have more money left over. My point may be different than the

others I saw a big difference in the board in terms of their attitude in regards to the fund balance. It had no importance then it got a little important then it got real important. It changed so much with the personalities on the board with the influence of the superintendent.

### *Key Factors to Regaining Fiscal Solvency*

**Interviewer:** In your opinion, what were the key factors, which contributed to regaining fiscal solvency?

**S. #1:** Certainly, better and more conservative revenue forecasting...there were additional staff brought into the business function, the creation of a CFO position (2002); the previous associate superintendent for business operation was taken out of the finance function and put solely in operations. As the school district grew rapidly from a 2A to a 5A school district there was virtually no breaking up the business support staff. We were clearly understaffed on that side.

There were several steps that were undertaken:

- 1) The District changed financial advisors (2002) – not that we were getting poor financial advice but we had been 28 years with same financial advisor; when that occurs the relationship becomes too familiar.
- 2) The District changed external auditors (2001).
- 3) The District considered revising tax collections; in an arrangement or partnership with the city of Cedar Hill. We looked at the advantages



of going with Dallas County as well as a set of consortium of neighboring school districts. We opted to stay with the city.

- 4) On the expenditure side, we found that many of the TEA budgetary codes were not being accurately utilized in budget development. In the second year we reorganized expenditures through a series of budget amendments. We were using management software that was poorly suited for our needs. We were their largest clients... in 2003-04 we went with the Skyward software system.
- 5) We did reduce teaching positions across the district by 38 positions. We took those recaptured dollars and invested them into salaries in order to make salaries market competitive. We did reorganize central office level...with a reduction in two positions. The reduction wasn't all that significant in dollars and it flattens the organization. On the instruction side, an assistant superintendent reported to an associate superintendent...as the organization has been flattened the nine (ten) directors now report to the superintendent. That is probably more than would be recommended by organizational specialist. Yet, it works in the short term in order to be particularly hands-on. I am not sure how long we will stay with this...we will stay at least to 2003-04.
- 6) The District sought to eliminate programs...we eliminated block scheduling at the high school and the middle school that is the only way to reduce the most number of teachers. I would say to you that

was purely a fiscal decision, a matter of fiscal priority. No one was advocating that 7 period day was better instructional time. We did make a move towards our highest priority, which was getting salaries up. We had been historically lower; Duncanville, DeSoto, and Cedar Hill had turnover rates of teaching staffs of 19-25%. And historically, particularly DeSoto and Cedar Hill had been well off the Dallas market. So there was quite a pattern of teachers joining those districts three or four years and going to higher paying North Dallas school districts. Both Duncanville and Cedar Hill are close to that market 02-03 and 03-04 teacher turnover rate dropped down to 19% and our refined teacher turnover rate and you take out those ...was 10%. State wide we are talking 15-16%. In the Metro areas there is more mobility.

- 7) The District addressed the concept of Block Scheduling, which we had been on for 7-8 years; it was well accepted; teachers at the high school had taught on nothing but the block schedule. We made a fiscal decision; administration recommended to the board a fiscal decision, which did result in the elimination of 38 teaching positions in which 17 of those were at the high school and then we said to the high school here are your staffing announcements for next year you determine the instructional schedule... We had largely determined that when we made that but in fact, they had made the determination. There are

some districts (Ennis) in similar situation but I don't think that they reduced quite the numbers at the high school. Their teachers opted to stay on block scheduling.

- 8) The State system is not particularly conducive to multi year budgeting...of course, we have trimmed a number of revenue measures, expenditures measures, trimmed student enrollment data, and we use a demographer to assist in enrollment projections. We have adopted a practice (first year I came here) the board considered and approved revenue assumptions early on to guide the staff in developing on the revenue side. Similarly, we have been considering expenditure assumptions. But, we take assumptions and use that to project out at least one year and sometimes two.

The State mandated changes – TSPR; I would have preferred not having TSPR; I would have preferred consultants...it did give me political cover needed to make changes. TSPR caused us to move more aggressively or rapidly.

**CFO:** The respondent outlined a “written laundry list” of some of the issues that were addressed specifically in the last two years by the Cedar Hill ISD:

- 1) The District used real data to decide the self-insurance issue, along with the expertise of a consultant and site-based committee. The District reached a resolution by going with the State of Texas TRS Active-care and getting out of the insurance business.

- 2) The District changed the fiscal year to align with the Federal Programs. Also, this enables principals/directors to purchase items with their new budgets for the appropriate year. Furthermore, over time, this will allow us to look at each budget year by school year. Now, a small portion of the August school year, both expenditures and revenues, are missing. There is a one time only advantage to switching that creates an excess of budgeted funds (10 month year versus 12 month year). This savings will be used to collapse our health insurance fund that currently is in the “red.”
- 3) The District implemented 100% of the financial recommendations by the Comptroller’s Office in a TSPR review.
- 4) The District realigned the coding structure. In particular, complying with PEIMS codes and then teaching principals and directors the codes that are used by TEA and ultimately that we must use.
- 5) The school board stated as a goal to increase our bond rating. We did not receive a PSF<sup>1</sup> backing from the state the last time bonds were sold by Cedar Hill ISD. This year not only did we receive PSF backing from the State but our underlying rating was increased.
- 6) The District has changed software companies effective September 1, 2003. This implementation was long overdue and the financed software is now windows based and very user friendly.

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<sup>1</sup> As of October 31, 2002, the principal value of 2,874 bond issues outstanding in Texas school districts totaled nearly \$29 billion, according to the Municipal Advisory Council of Texas. About \$26 billion was guaranteed by the Permanent School Fund (PSF), which is managed by the State Board of Education with the help of investment advisors and Texas Education Agency (TEA) staff. The statewide school debt is approaching the maximum amount that can be guaranteed by the PSF.

- 7) The superintendent and I have publicly stated that our budget philosophy is to underestimate revenue and overestimate expenditures. Thus, by implementing this simple strategy, it creates an “automatic” fund balance each year.
- 8) I have had two positions retire this year and I was able to replace them with experienced, qualified individuals that are adaptable to change. The adaptability to change is a real key for my staff to be effective under my leadership style. The District reconciled of all checking accounts and investments are done within 20 days from the month’s end. In the past, this process was sometimes behind schedule.

**S.B.P. #1:** All of that [changes in accounting procedures, additional staff in the business office, reduction in force, elimination of programs, multi-year budgeting planning, state mandated changes, better revenue forecasting] and another thing I could bring was a change in attitude on the board. There was a renewed energy and renewed commitment that we did budget for the fund balance. I can remember a time years ago when it was wouldn’t that be nice if we could do that oh no, let’s spend it on something else. That was a dramatic change. So much of it is luck. We live at the whim of other people. We are playing by the rules and the rules keep changing. We have the advantage of a steady growth rate and as long as that is happening we have more money coming in.

**TEA Representative:** The most important area for building financial strength is cost reduction in the area of personnel. A school district should understand how

many staff could be supported given the revenue characteristics of the school district, potential local revenue generating process from property taxes and state aid and also financing sources involving projects and grants. The district should have the ability to quantify how many individuals can be supported on their payroll and the amount that can be left over that can be financed from the residual amount of revenues or the use of fund balance.

### *Utilizing TEA Tools*

**Interviewer:** How were the fiscal tools of the Texas Education Agency used in resolving the problem?

**S. #1:** We of course use the templates. There are both strengths and deficiencies with the templates. Our CFO from time to time contacts the TEA staff especially when revenue projections change with the legislature. Our CFO's experience in west Texas and her work with the regional service centers have been helpful. Seminars and professional development put on by the TEA are extremely helpful. We brought in an outside consultant unrelated to TEA to help us look at where we were at in terms of long-range projections and to make certain we were maximizing our revenues.

CFO: Well, I will say this up front they are my friends. I will calculate the first report card long before they give me the results based on this year's template. I have a problem with the "Omar" template as I still call it that it will really predict my finances. I will call associates before I will try to reach TEA. They (TEA) have influenced my career choices in the past.

## Summary

A review of PEIMS data, board minutes, audit reports, financial records, management audit, and interviews with key informants indicated that the following were the circumstances immediately prior to and during the insolvency of the Cedar Hill

Independent School District:

- 1) There was a history of negative fund balances. See Appendix B.
- 2) Expenditures outpaced revenues.
- 3) Even though the enrollment of the school district had grown, there was excess staffing at the high school.
- 4) The district supported ongoing program expenses with incurred debt.
- 5) There was virtually no accurate revenue forecasting.
- 6) Despite the growth of the school district the business office had been understaffed.
- 7) TEA budgetary codes were not being accurately utilized in budget development.
- 8) TEA denied the Permanent School Fund (PSF) guarantee for the October 2001 bonds costing the district \$248,000 in bond insurance premiums in lieu of the normal \$300 Permanent School Fund guarantee fee.
- 9) The district has gone from an already low \$612,623 (2.6 percent) fund balance in 1996-97, to a negative \$2.7 million (0 percent) in 2000-01.
- 10) A projected positive fund balance of approximately \$900,000 at the end of 2001-02 was not reached because the district had not taken into account the negative fund balance in the health insurance fund.

- 11) There was no strong system of internal controls.
- 12) There was no stabilizing financial management.
- 13) There was no streamlining of organization and management using highly qualified staff.
- 14) There was no enforcing contract oversight and compliance.

The key factors identified by those interviewed as contributing to regaining fiscal solvency were the following:

- 1) Restructuring the financial management's organization and hiring a Chief Financial Officer.
- 2) Adopting policies to prevent deficit budgeting and amending deficit budget.
- 3) Adopting procedures to set premiums and to adjusting contributions to the district's self-funded health plan based upon actual projections. Monitoring actual activity quarterly to ensure solvency of the plan.
- 4) Reorganizing central office administration and applying industry-staffing formulas at campus levels.
- 5) Implementing procedures for data collection, review and submission to ensure the integrity of Public Education Information Management System (PEIMS) submissions.
- 6) Obtaining competitive proposals for external audit services every five years, and hiring an internal auditor.
- 7) Consolidating maintenance and custodial management.
- 8) Establishing offsetting controls for cash and investment transactions.



## Uvalde Consolidated Independent School District

### *Financial Ratios*

The researcher applied four descriptive financial ratios to the Uvalde Consolidated Independent School District. Saul (1996) studied the possibility of using financial ratios as a tool for analyzing and predicting insolvency in California school districts. In the first ratio, R-3 or Reserve for Economic Uncertainties to Total Expenditures, the researcher again substituted the Ending Fund Balance in the General Fund for the Reserve for Economic Uncertainties. For the FY 2000-01 the ratio of Ending Fund Balance to Total Expenditures was negative  $\$49,618/\$32,674,534$  or 0. For FY 2001-02 this ratio was  $\$201,271/\$32,123,818$  or .006. For FY 2002-03 the ratio was  $\$779,818/\$33,291,604$  or .0234. There is a substantial increase during this time frame, which indicates movement of the Uvalde Consolidated Independent School District toward solvency.

The second ratio applied to the Uvalde Consolidated School District was R-13, Property Tax as a Percentage of General Fund Revenues. An increase in this ratio would indicate placement of a school district into the group of solvent districts; a decrease would indicate placement into the insolvent group. During FY 2000-01 the ratio was  $\$7,089,782/\$32,865,452$  or 0.2157. For FY 2001-02 this ratio was  $\$7,413,495/\$32,158,345$  or 0.23053. In FY 2002-03 revenues from property tax was  $\$7,902,038$  while general fund revenues totaled  $\$33,351,758$ . The ratio became 0.23693.

The third ratio used was R-17, Cash to Current Liabilities to test the ability of a school district to meet current obligations immediately. For FY 2000-01 this ratio was

\$4,312,196/\$4,070,933 or 1.059. In FY 2001-02, the ratio was \$4,135,538/\$3,043,807 or 1.358. In FY 2002-03 the cash was \$5,697,389 and the liabilities were \$2,190,728.

Thus, the ratio for FY 2002-03 was 2.600. An increase in this ratio would indicate the solvent group. The FY 2003-04 shows a substantial increase in cash and a sizable decrease in liabilities.

The final ratio used was R-22, Benefits to Total Expenditures. An increase in this ratio would suggest placement into the insolvent group; a decrease would suggest solvency. For FY 2000-01 the ratio of Benefits to Total Expenditures for the Uvalde Consolidated School District was \$4,044,037/\$32,674,534 or 0.12. For FY 2001-02 the ratio became \$4,294,211/\$32,123,818 or 0.133. In FY 2002-03 the ratio became \$4,546,814/\$33,291,604 or 0.136. For this particular ratio a decrease indicates placement in the solvent group. For the last three years, the trend appears to be increasing, which would place the Uvalde CISD toward the insolvent group.

The results of the application of the four financial ratios to the Uvalde CISD are provided in Table 4.

Table 4  
Uvalde Consolidate Independent School District Ratios

	FY 2000-01	FY 2001-02	FY 2002-03
R-3	0	0.006	0.0234
R-13	0.215	0.230	0.236
R-17	1.059	1.358	2.600
R-22	0.12	0.133	0.136

R-3 - Reserve for Economic Uncertainties to Total Expenditures.

R-13 – Property tax as a percentage of total General Fund revenue.

R-17 – Cash to Current Liabilities

R-22 – Benefits to Total Expenditures

*Background information*

The Uvalde Consolidated Independent School District is located approximately 83 miles west of San Antonio, Texas. The district is classified by the University Interscholastic League (UIL) as a 4A high school district, which means it has a student enrollment of 900 to 1,924. The district serves 5,197 students from pre-kindergarten through grade 12. It serves an area of 1,150.5 square miles with the majority of the district in Uvalde County with a small portion extending into both Real and Zavala Counties. This school district has one Dalton Early Childhood Center; 4 elementary schools; 2 middle schools (Batesville School, Uvalde Junior High); and one high school. As of the 2003-04 school year the district’s ethnic diversity was 0.5 percent African American; 14 percent White; 85 percent Hispanic; and 0.4 percent Other.

Exhibit 4-12 details the enrollment and demographic characteristics of Uvalde CSD, its neighboring peer districts, Regional Education Service Center (Region 20) and the state.

Exhibit 4-12  
Student Enrollment and Demographics  
Uvalde CISD, Peer Districts, Region and State  
2003-04

District	Student Enrollment	African Americans %	Hispanic %	White %	Asian/Pacific Islander %	Native American %	Economically Disadvantaged %
<b>Uvalde CISD</b>	<b>5,197</b>	<b>0.5</b>	<b>85</b>	<b>14</b>	<b>0.4</b>	<b>0.0</b>	<b>74</b>
Sabinal ISD	549	0.7	68	30	0.7	0.0	66
Crystal City ISD	2,074	0.9	98	1	0.0	0.0	88
Pearsall ISD	2,278	0.8	88	11	0.3	0.0	82
<b>Region 20</b>	<b>343,821</b>	<b>7</b>	<b>65</b>	<b>27</b>	<b>1.3</b>	<b>0.3</b>	<b>62</b>
<b>State</b>	<b>4,239,911</b>	<b>14</b>	<b>43</b>	<b>40</b>	<b>3</b>	<b>0.3</b>	<b>52</b>

Source: Texas Education Agency (TEA); Public Education Information Management System (PEIMS), 2003-04.

Note: Totals may not add to 100 due to rounding.

UCISD has less business and less residential property value than the state average, yet it has more than all peer district averages (Exhibit 4-13). The higher percentage of residential value for UCISD indicates that local residents carry most of the local property tax burden to fund school operations. Land accounts for more than 18 percent of UCISD’s property value, which is lower than any of its peers but higher than the regional and state averages. The higher land value indicates the potential for continued property development growth in UCISD.

Exhibit 4-13  
 Uvalde CISD, Region 20, State and Peer District Property Values by Category  
 as a Percentage of Total Property Value  
 2002-03

District	% Business	% Residential	% Land	% Oil and Gas	% Other
Sabinal ISD	17	40	42	0.0	1.0
<b>UCISD</b>	<b>33</b>	<b>46</b>	<b>18</b>	<b>0.2</b>	<b>1.9</b>
Crystal City ISD	32.9	29.0	28.0	8.9	1.2
Pearsall ISD	32	29	31	4.2	3.1
<b>Region 20</b>	<b>30.5</b>	<b>60.9</b>	<b>7.4</b>	<b>0.3</b>	<b>0.9</b>
<b>State</b>	<b>36.3</b>	<b>52.2</b>	<b>6.7</b>	<b>3.5</b>	<b>1.2</b>

Source: Texas Education Agency (TEA), Academic Excellence Indicator System (AEIS), 2002-03

The state assigns funds for school program costs based on property values per student. UCISD’s developmental growth and the corresponding increase in property values have caused an increase in the proportion of funding coming from local property taxes. From 1997-98 through 2002-03, local revenue as a percentage of total funding for UCISD increased by 19 percent. At the same time, state revenue as a percentage of total funding decreased by 2.8 percent (Exhibit 4-14).

Exhibit 4-14  
UCISD Sources of Revenue as a Percentage of Total Revenue  
1997-98 through 2001-02

Source of Revenue	1997-98 %	1998-99 %	1999- 2000 %	2000-01 %	2001-02 %	2002-03 %	Percentage Change 1997- 98 to 2002-03
Local Property Tax	19.8	18.3	20.6	22.4	23.1	23.57	19
Other local and intermediate	3.4	3.6	3.0	2.2	2.1	2.36	(30.5)
State	71.4	77.8	75.9	74.9	74.0	73.43	(2.8)
Federal	5.4	0.3	0.5	0.5	0.9	0.65	(87.9)

Source: TEA, Public Education Information Management System (PEIMS),  
1997-98 through 2002-03

In 2002-03, Texas school districts budgeted an average of 51.9% percent of their funds from the local property tax and 40.5 percent in revenue from the state (Exhibit 4-15). In UCISD, those percentages are 23.7 and 68.5 percent, respectively. The averages for the region are 37.1 and 52.3 percent, closer to the state average.

Exhibit 4-15  
UCISD, Region 20, State and Peer District  
Sources of Budgeted Revenue as a Percentage of Total Budgeted Revenue 2002-03

Entity	% Local Property Tax	% Other Local and Intermediate	% State	% Federal
Sabinal ISD	29.2	3.2	63.5	4.1
<b>UCISD</b>	<b>23.7</b>	<b>2.8</b>	<b>68.5</b>	<b>5.0</b>
Crystal City ISD	12.1	1.2	80.4	6.2
Pearsall ISD	23.1	3.1	68.2	5.5
<b>Region 20</b>	<b>37.1</b>	<b>5.6</b>	<b>52.3</b>	<b>5.0</b>
<b>State</b>	<b>51.9</b>	<b>4.2</b>	<b>40.5</b>	<b>3.5</b>

Source: TEA, AEIS, 2002-03

*District Mission Statement*

The mission statement of the district states that “through effective leadership, comprehensive district and campus planning, a safe school environment, and participation from school staff, parents, students, and community members, the Uvalde Consolidated Independent School District commits to develop students who possess positive self-esteem and the knowledge and skills for future learning” (Uvalde C.I.S.D.

brochure, July, 2004). The four-year high school completion rate for the Uvalde Consolidated Independent School District is 76.7 percent. This is accomplished with a total district budget of approximately \$34 million for the 2003-04 year. In August 2003, UCISD's adopted tax rate was \$1.61 (\$1.43 maintenance and operations plus \$.17 debt service) after a series of increases from the 1996-97 adopted tax rate of \$1.52 (\$1.214 maintenance and operations plus \$0.306 debt service). At the same time, UCISD's property value reached \$97,892 per student, compared to the state average of \$242,809 per student (Exhibit 4-16).

Exhibit 4-16  
Uvalde CISD Comptroller Tax Rates, Assessed Property Values  
And Per Student Property Values  
1996-97 through 2002-03

Category	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	Percentage Change
Maintenance and Operations tax rate	\$1.214	\$1.121	\$1.155	\$1.340	\$1.400	\$1.400	\$1.434	17.7
Interest and Sinking fund tax rate	\$0.306	\$0.282	\$0.365	\$0.180	\$0.120	\$0.120	\$0.179	(41.5)
Total Tax Rate	\$1.520	\$1.403	\$1.520	\$1.520	\$1.520	\$1.520	\$1.613	6.1
Total Property Value (000s)	\$383,589	\$401,889	\$410,393	\$433,210	\$470,040	\$481,255	\$508,746	32.6
Total Students	5,462	5,307	5,293	5,323	5,221	5,203	5,197	(4.85)
Value per student	\$70,229	\$75,728	\$77,535	\$81,385	\$90,029	\$92,496	\$97,892	39.3

Source: TEA, Academic Excellence Indicator System (AEIS), 1996-97 through 2002-03.

### *Expenditures*

On the expenditure side, Exhibit 4-17 shows how UCISD distributed budgeted funds in 2002-03 compared to the state average. Of particular significance is UCISD's allocation to the instructional category, which is lower than the state average. Also, the school district's distribution for food service, central administration and co-curricular/extracurricular activities is higher than the state average. Food service is

higher in the UCISD because it has a higher percentage of lower socio-economic students (SES). Transportation costs because of the large area of bus miles and food service costs make up the difference in terms of allocation to the instructional category.

Exhibit 4-17  
UCISD and State Total Budgeted Expenditures by Function as a Percentage of Total Budgeted Expenditures  
2002-03

Function	UCISD	Percentage Spent	State	Percentage Spent
Instruction (11,95)	\$16,351,762	54.3	\$15,258,107,372	57.0
Instructional-Related Services (12,13)	\$737,553	2.4	\$815,176,913	3.0
Instructional Leadership (21)	\$947,711	3.1	\$360,073,948	1.3
School Leadership (23)	\$1,682,297	5.6	\$1,588,708,640	5.9
Support Services-Student (31,32,33)	\$1,242,735	4.1	\$1,204,538,130	4.5
Student Transportation (34)	\$1,242,735	4.3	\$788,729,993	2.9
Food Services (35)	\$1,814,700	6.0	\$1,470,996,886	5.5
Co-curricular/Extracurricular Activities (36)	\$1,101,292	3.7	\$682,584,402	2.5
Central Administration (41)	\$1,336,436	4.4	\$1,090,220,713	4.1
Plant Maintenance & Operations (51)	\$3,328,080	11	\$2,995,707,896	11.2
Security & Monitoring Services (52)	\$188,631	0.6	\$181,806,687	0.7
Data Processing Services (53)	\$112,475	0.4	\$348,481,432	1.3
Total Budgeted Expenditures	\$30,139,996	100.0	\$26,785,133,012	100.0

Source: TEA, PEIMS, 2002-03.

A longitudinal presentation of expenditures for the school district is presented in Exhibit 4-18. All expenditure function areas for Uvalde CISD increased with the exception of Instructional Related Services, which decreased by 6.4 percent. This function on the state level increased by 62.3 percent. The leading increases in spending for functional areas were Instructional Leadership (71.9) and Student Transportation (75.5) for Uvalde CISD. The state averages in Instructional Related Services increased by 62.3 percent. While increases in Instructional Leadership were 37.8 percent and in Transportation Services they were 54.2 percent on the statewide levels.

Exhibit 4-18  
A Longitudinal Presentation of UCISD Budgeted Expenditures by Function  
FY 1996-2002

Function	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	Percentage Change
Instruction (11,95)	\$14,356,153	\$15,201,666	\$15,270,300	\$16,064,089	\$16,186,858	\$15,246,964	\$16,351,762	13.9
Instructional-Related Services (12,13)	\$788,088	\$766,101	\$800,616	\$836,891	\$749,276	\$783,468	\$737,553	<b>(6.4)</b>
Instructional Leadership (21)	\$551,337	\$671,107	\$842,946	\$741,267	\$812,809	\$742,721	\$947,711	<b>71.9</b>
School Leadership (23)	\$1,367,092	\$1,519,022	\$1,623,647	\$1,631,508	\$1,851,008	\$1,804,826	\$1,682,297	23.1
Support Services-Student (31,32,33)	\$886,130	\$918,544	\$913,908	\$1,008,981	\$1,085,975	\$1,016,688	\$1,242,735	40.2
Student Transportation (34)	\$738,443	\$792,816	\$1,034,925	\$1,018,182	\$1,176,183	\$1,228,976	\$1,296,324	<b>75.5</b>
Food Services (35)	\$1,582,813	\$1,812,422	\$1,918,895	\$1,944,500	\$2,009,592	\$1,949,427	\$1,814,700	14.7
Co-curricular/Extracurricular Activities (36)	\$707,863	\$750,414	\$839,617	\$760,365	\$860,640	\$909,402	\$1,101,292	55.6
Central Administration (41)	\$939,082	\$975,676	\$1,053,132	\$1,110,154	\$1,257,847	\$1,388,138	\$1,336,436	42.3
Plant Maintenance & Operations (51)	\$2,330,641	\$2,732,232	\$2,695,239	\$2,745,308	\$2,847,664	\$3,342,378	\$3,328,080	42.8
Security & Monitoring Services (52)	\$0	\$117,739	\$122,539	\$233,852	\$243,916	\$247,597	\$188,631	60.2
Data Processing Services (53)	\$105,508	\$87,206	\$106,604	\$104,725	\$106,376	\$111,425	\$112,475	6.6
Total Budgeted Expenditures	\$24,353,150	\$26,344,945	\$27,222,368	\$28,199,822	\$29,188,144	\$28,772,010	\$30,139,996	23.8

Source: TEA, PEIMS, FY 1996-FY 2002

On a per student basis from 1997-98 to 2002-03, UCISD's expenditures have increased 17.7 percent (Exhibit 4-19). Instruction and instructional leadership spending has increased 11.3 percent, or \$338, per student while school leadership spending has increased 13.2 percent, or \$38, per student.



Exhibit 4-19  
UCISD Expenditures per Student  
1997-98 through 2002-03

Expenditure Category	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	Percentage Change
Instruction and Instructional Leadership	\$2,991	\$3,044	\$3,157	\$3,256	\$3,073	\$3,329	11.3
School Leadership	\$286	\$307	\$307	\$355	\$347	\$324	13.2
Central Administration	\$184	\$199	\$209	\$241	\$267	\$257	39.6
Other operating	\$1,503	\$1,593	\$1,626	\$1,739	\$1,843	\$1,890	25.7
<b>Total operations</b>	<b>\$4,964</b>	<b>\$5,143</b>	<b>\$5,298</b>	<b>\$5,591</b>	<b>\$5,530</b>	<b>\$5,799</b>	<b>16.8</b>
<b>Total per student</b>	<b>\$5,440</b>	<b>\$5,847</b>	<b>\$5,922</b>	<b>\$6,258</b>	<b>\$6,174</b>	<b>\$6,406</b>	<b>17.7</b>

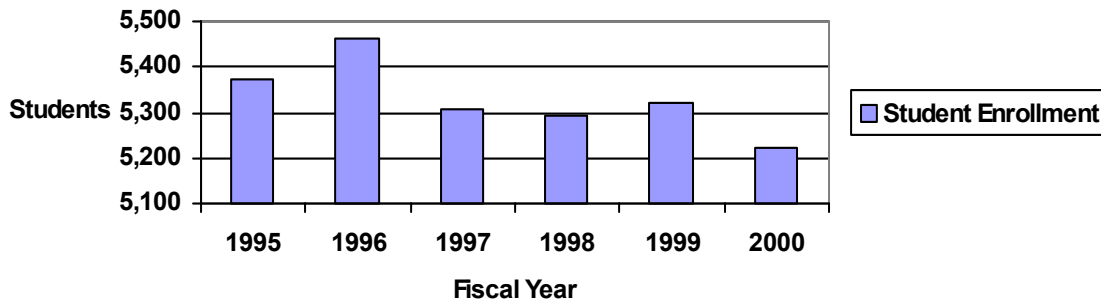
Source: TEA, PEIMS, 1997-98 through 2002-03

The increase in central administration (39.6 percent) appears significant during this time frame.

*Historical Summary*

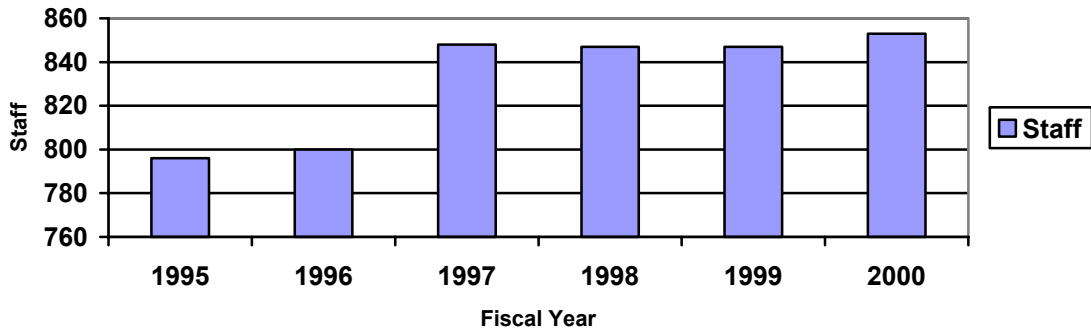
The fiscal crisis of the Uvalde Consolidated Independent School District stems from several problems that became more severe between FY 2000-01 and FY 2001-02. It was during this time frame district student enrollment decreased by 1.5 percent (Exhibit 4-20) while staffing increased by 16.7 percent (Exhibit 4-21).

**Uvalde CISD Student Enrollment FY 1995-2000 Exhibit 4-20**



Source: TEA, PEIMS, FY 1995-2000

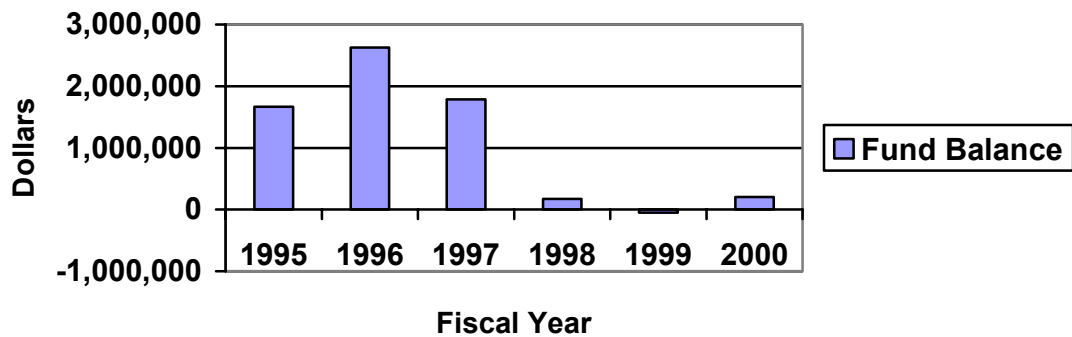
### Uvalde CISD Staffing FY 1995-2000 Exhibit 4-21



Source: TEA, PEIMS, FY 1995-2000

The district was also experiencing a negative fund balance, which began to appear in 1994-95 (Appendix C). This can also be viewed in Exhibit 4-22 below.

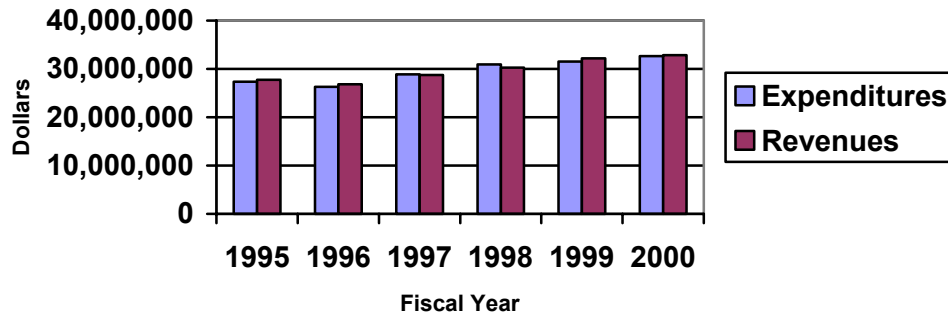
### Uvalde CISD Fund Balance FY 1995-2000 Exhibit 4-22



Source: TEA, PEIMS, FY 1995-2000

Expenditures had exceeded revenues in FY 1997, FY 1998 and FY 2001 (Appendix C). Exhibit 4-23 also depicts the scenario of the school district from fiscal year 1995 through fiscal year 2000.

## Uvalde CISD Expenditures/Revenues FY 1995-2000 Exhibit 4-23



Source: TEA, PEIMS, FY 1995-2000

The financial problems of Uvalde Consolidated Independent School District were critical. The district's unreserved fund balance was unstable as it was greater than 20 percent (TEA recommendation, FIRST indicator #19) over 2 fiscal years (Exhibit 4-24).

Exhibit 4-24  
Fund Balance Instability

Year	Actual Fund Balance	Less 20%	Projected Balance
1996-97	\$2,626,920	\$525,384	\$2,101,536
1997-98	\$1,784,327	\$356,865	\$1,427,462
1998-99	\$172,117	\$34,423	\$137,694
1999-2000	(\$49,618)	-	-

The TEA issued a 'substandard achievement' rating to the school district because of failure for indicator 1, 14, 17 and 18. Both indicators 1 and 18 dealt with negative fund balance and insufficient total fund balance (Appendix C). Indicators 14 and 17 (Exhibit 4- 25) dealt with insufficient ratios of cash and investments to deferred revenues and ratios of students to total staff. The instrument is designed to rate a district in the 'substandard achievement' category if it answers NO to indicator 1.

Exhibit 4-25  
Indicator #17 FIRST Worksheet

Year	Total # of Students	Total # of Staff	Ratio
1997-1998	5,307	848	6.25
1998-1999	5,293	847	6.24
1999-2000	5,323	847.87	6.27
2000-2001	5,221	847.59	6.15

Source: TEA, PEIMS, 1997 through 2001

The recommended ratios for a school district this size was greater than 6.5 and less than 14 (FIRST Worksheet, 2000).

The district experienced negative student growth as well as increases in total staff in a ten-year period. The enrollment of the district declined from 5,277 (1994-95) to 5,197 (2002-03) with a peak of 5,323 (1999-00). While total staff increases included 681 (1994-95) to 795 (2002-03). Furthermore, the school district pupil/teacher ratio had grown from 13.6 (2000-01) to 14 (2002-03). It is interesting to note the dominance of non-professional employees in the school district.

Table 3  
Uvalde CISD  
Student Enrollment – Professional Employees/Total Staff

Year	Enrollment	Professional Employees/Total Staff	% Ratio of Employees to Total Staff
1993-094	5,277	395/681	58.0
1994-95	5,279	369/548	67.3
1995-96	5,371	436/796	54.7
1996-97	5,462	441/800	55.1
1997-98	5,307	454/848	53.5
1998-99	5,293	451/847	53.2
1999-00	5,323	475/847	56.0
2000-01	5,221	471/853	55.2
2001-02	5,203	449/814	55.1
2002-03	5,197	455/795	57.2

Source: TEA, PEIMS, 1993-94 through 2002-03

### *Organizational Plan*

In October of 2000, with a negative fund balance of nearly \$31,000, the trustees for the Uvalde Consolidated Independent School District implemented a new fund balance policy requiring that two and one-half months' worth of operating funds be in reserve by October 2005 (Merritt, 2004).

The district's human resources were reorganized with the following key concepts in mind: (a) elimination of a warehouse director to be assumed under the Executive Director of Business Services, (b) greater decision making for the uses of resources at the site level, (c) reduction of staff through attrition in the school district and business office, and (d) a change in accounting procedures through the office of Executive Director of Business Services.

The next section contains interviews with several leading stakeholders that were critical in terms of understanding the fiscal decision-making within this school district.

#### On-Site Interviews

On June 7, 2004, the researcher traveled to Uvalde, Texas to interview the following individuals: superintendent (S. #2) who was hired on July 20, 2000; Executive Director of Business Services (EDBS) who had been in that position since Thanksgiving, 2001; and the school board president (S.B.P. #2). He had just finished his first month as President and had served on the Board for seven years. The TEA Representative was interviewed in Austin, Texas on June 15, 2004.

## *Analysis*

The Uvalde Consolidated Independent School District was plagued by a lack of vision in terms of budgeting and decision-making. Leaders and stakeholders did not understand the dynamic relationship between a declining student enrollment coupled with the increase in staffing and its potential for economic disparity. “The staff was not reacting with the budget plan based on what the data was telling them about” (EDBS, 2004). The school board was guided by an administration that was incremental in its regularity of spending. The district was not able to handle the complex budget processes utilizing rational techniques.

The administrative team of this school district utilized a more rational approach to budgeting following the TEA ‘substandard’ rating. They introduced common rational reforms to the budgetary process. “We implemented a modified zero-based budget planning process”(S. #2, 2004). Strategic choices were outlined to the board early the reform process through “I told them that there were two things that would have to happen in order for us to a positive financial situation. One, they needed a reduction in staff. Next, we needed to raise the tax rate” (S. #2, 2004). Budget periodicity was also addressed through “in October 2000 I took to the Board a policy for a 5 year target for fund balance” (S. #2, 2004).

The institution of board policy, which addressed the issue of negative fund balance as a multiple year quandary, bolsters further support for rational techniques in budget systems. Also, the district through rational budgeting was able to reduce total

expenditures in “we went back to build our budget with a projection of 4,700 students we cut \$75,000 from budget” (S. #2, 2004).

The district leadership directed the budgeting process utilizing the steps toward rational behavior. The superintendent understood the ramification of the economic circumstances that he was encountering before assuming the responsibilities of the job. This particular individual had encountered similar economic dilemmas in other districts. Equipped with this knowledge enabled him to clearly identify and communicate to the school board the direction in which the district must pursue in order to become economically solvent.

The fiscal conditions of the district were clearly and correctly addressed through the recruitment of a knowledgeable business manager coupled with more advanced computer software packages. Their loyalty and teamwork were also instrumental in terms of the achievement of success. Finally, the school board through better communication and education concerning the fiscal problems were able to unite in their agreement to a long-term proposal that led to economic solvency.

This knowledge base formed a foundation for the leadership team to select and pursue a course of action that enabled the district to rapidly respond to the criteria of the FIRST rating system. It is interesting to note that once the district had managed the deficit issue the political environment soon resurfaced with “even though we were half way there the people saw a positive fund balance and now you can relax all the stuff you have been doing” (EDBS, 2004).

The tools furnished by the TEA were used in resolving the problem in limited conditions in that the templates were useful in terms of organizing data and setting priorities. Furthermore, the tools assisted the leadership of the district to communicate the priorities to both the community and the board of trustees. Yet, those that were directly responsible for the development of the budget felt that more sophisticated methodologies were required in forecasting and processing of relational data.

#### *Thematic responses*

The respondent's answers are organized by research question themes to furnish the reader more insight into pre and post crisis period for the school district.

#### *Major Financial Duties*

**Interviewer:** What are the major duties relative to fiscal decisions or financial oversight in current job?

**S. #2:** As superintendent I serve as chief executive officer of the school district. In that regard I am responsible for the development of the budget and to make sure we stay within revenues for the district. So that we maintain a balanced operation and along with that I also have responsibility for all the facilities and that has to do fiscal decisions, and maintenance and operations of the facilities as well. Those are probably the major areas. Of course, I develop the budget in association with the Executive Director for Business Services and we present the budget for board approval. The fiscal year for this district runs from September 1 until the end of August. We typically finish our budget preparation sometime in



August and we begin that preparation sometime around the later part or the first part of March.

**EDBS:** Basically, I am the key developer of the budget. As far as a team we are viewed as an administrative cabinet and all the presentations from campus departments and I eventually act as a cabinet advisor to the board and superintendent and far as direction and what is feasible for the short term and long term. That is one of the primary focuses of the position. The others are budgetary control once we have a plan that is approved and it is put in place that we make sure there is compliance within the levels authorized and if there need be revisions to bring that to the attention of the superintendent and the board for possible required approval that we need to deviate from the financial plan. My title is Executive Director of Business and Support Services. A lot of my time is also taken up by overseeing bond construction effort. There is also oversight of maintenance, operations, transportation, and PEIMS. Besides the number crunching there is oversight of other support areas.

**S.B.P. #2:** Primarily getting reports and getting suggestions from the administration and determining policy for the district.

*Awareness of the Fiscal Problems of the District*

**Interviewer:** When did you first learn of the fiscal problems in the school district?

**S. #2:** Actually, I first learned the fiscal problems before I took the job of superintendent. I was heavily recruited by the Uvalde School District to serve as

their superintendent. When they started talking to me as their superintendent I want to say March of 2000 and when they asked me to consider the possibility of serving as their superintendent and then I went into the Internet and discovered that the district was in very poor financial health and I knew it would be a very big challenge in order to bring this district around and I explained that to the board when I interviewed with them.

**EDBS:** At our first board meeting...I came in after Thanksgiving 2001. The first board meeting was the first Tuesday of the month so in December they presented the audit so that was the first I heard. I guess I should be embarrassed to say that I didn't do my research but when you get the opportunity to come back home it was a non-issue for me. The audit cautioned of the negative fund balance. From the get go the task was clearly identified.

**S.B.P. #2:** I believe in 1997 we had a large class graduate and approximately at the same time we passed a bond for campus improvements. After that large class graduated we had a charter school started. I think that a combination of things started things going in a bad direction. The next year we an enrollment drop and we had an independent company forecast growth and they did feel that this was a problem. Then the second year we lost some more students, which exacerbated the problem. In 1998 or 1999 we started to realize that this would be an anomaly.

*Circumstances Prior to the Period of Fiscal Insolvency*

**Interviewer:** What were the circumstances immediately prior to the 'substandard' rating?

**S. #2:** The one thing I did not know before I came to the district was that the district was overspending a million dollars of overpayment from the state. So not only did they have a fund balance problem but they were actually spending more; about one million dollars that they were being over paid by the state because their ADA was down from what they thought it was and I discovered that when I came to the district and the financial situation of the district was a surprise to the board members because I remember them telling me that they did not realize that the district was in the financial situation it was in and one of the things that I decided to do was keep the board members very informed in that they would not be able to say like they did with me when I interviewed and told them of the financial condition of the district and they said we did not know that was the case with our district and I said yeah it is, I think boards trust administration and they should trust but sometimes administration does not have the knowledge to make the appropriate financial decisions and part of the reason is that they do not understand the total financial picture of school finance. It is not that they are making wrong decisions, it that they don't have everything they need to make the appropriate decisions and so I would make sure the board was very informed about everything we were doing as a district related to the financial position so that there could be no surprises and they would know exactly where we were financially. I shared about the overpayment.

**EDBS:** Our ADA peaked in 1997 while our staffing was growing. By the end of 2001 for that audit with ADA down and staffing going up there was a crossing

and there was the deficit. Our revenues went down and we kept adding the biggest part of our budget plan, staff. Not to speak negatively of anyone who was here but it seems like the understanding or the monitoring of the big picture of these two items was not understood; I did not know the “politics” of the time. The staff was not reacting with the budget plan based on what the data was telling them about. This is where the discussion needs to be at...you can talk nickels and dime stuff but what I found here is to pull away. The state has a system to project the amount of revenue you earn. They forward you what they call foundation monies based on a schedule of what they project from two years ago and what districts submitted their ADA or enrollment. They calculate what they need to send you and then at the end of the fiscal year in the following month in the next fiscal year if they overpay you they recover that; if they underpay you they make up the difference. But in our district we had been relying on the overpayment to meet operations so I think the illusion of it's OK was occurring because that overpayment in the neighborhood of \$1-2 million every year but it was being recovered. The best way I could and this was a heated discussion with the Board was describe it was what if the Legislature goes to real time funding. If they go to real time funding we will realize an impact of \$2 million. It would be financial irresponsible of me to ignore that possibility. It may not occur but I'm trying to have the actions and decisions we make to take into account the buffer that could be gone from one year to the next and we do not want to put the district in a position where they are going to have to face that animal. I think when we were

having those discussions this was a foreign concept to the board. There was a lot of education that had to go on. That was another piece that had to go because the awareness was not there. My experience in other states is that you were always funded based on the enrollment of the prior year. It was known. Then if there was growth they had formulas that would adjust in the following years. They were talking about real time funding in the other state and when I arrive here and being involved with TASBO and following I could tell that is where we are headed here because the state is trying to make up some ground and logically if they were to move to that they would avoid overpaying which they do more of than underpay. I think that this was a turning point and coming to grips that we need to monitor that and that our budget plan from year to year account for the possibility of an overpayment.

**S.B.P. #2:** Well when we passed the bond it was the board commitment to not raise taxes for five years and we followed through on that. Then with the drop in enrollment that first year the district spent the revenues that were expected from ADA. The second year we realized it was a real problem and then the state withheld the funds. The revenue dropped and there was decline in enrollment.

### *Contributing Factors*

**Interviewer:** Was error in predicting revenue or enrollment a contributing factor?

**S. #2:** Error in revenues...anticipating. Superintendent is only as good as his staff. They did not understand the overall financial situation...they did not realize

that they were overspending over one million dollars...error in predicting revenue based on ADA. Business director left shortly after my arrival. We were fortunate to get someone who really understood school finance.

**EDBS:** I think after looking at some of the data that expenditures were exceeding revenues...ADA versus expenditures.

**S.B.P. #2:** Yes, predicting revenue and enrollment were a factor.

### *Key Factors to Regaining Fiscal Solvency*

**Interviewer:** In your opinion, what were the key factors, which contributed to regaining fiscal solvency?

**S. #2:** I went into the Internet and discovered that the district was in very poor financial health and I knew it would be a very big challenge in order to bring this district around and I explained that to the board when I interviewed with them. I told them that there were two things that would have to happen in order for us to a positive financial situation. One, they needed a reduction in staff. Next, we needed to raise the tax rate. They asked me to eliminate staff by attrition rather than reduction in force and to not consider a tax increase for five years from a date they had pre decided for the passage of a bond issue. This bond package included \$40 Million in bonds sold. I promised not to raise taxes in the 2000-01 school year. With a commitment from the board, I could ask to raise taxes in July or August for my first year here. Then I thought we would be able to survive OK. I got an informal audit from TEA. I wrote a letter to the Associate Commissioner for Finance and Compliance three and half weeks after I got to the district. I

asked for a prospectus. It took 11 months...they shared some interesting information in their August 22, 2001 letter that led to the following:

- 1) The institution of a Personnel Management Plan, which froze hiring and began a constant evaluation of positions. This plan brought the elimination of over 100 positions in the district. It has been tough...yet, positive as everybody got on board in doing what needed to be done.
- 2) The development of a Financial Management Plan, which addressed the tax rate.
- 3) In October 2000 I took to the Board a policy for a 5-year target for fund balance. I might be gone; school board members might be gone. We will get to a \$3.5 million-fund balance. Revision of board policy because not achieving because of 1.2 million in pay increases.
- 4) Monitoring of attendance for ADA. We went back to build our budget with a projection of 4,700 students we cut \$75,000 from budget. This was absorbed at central office not on the campus. We took this information to the board.
- 5) There had been a misidentification of one million dollars in overpayment from the state.
- 6) Review of the policies, which related to expenditures.

Also, the following changes were outlined:

- 1) A change in accounting procedures in terms of sharing more with the board in terms of expenditures and board approval rates.
- 2) The sharing more information with board and community in terms of where the money is being spent especially in contracted services up to \$15,000.
- 3) The reduction of staff in the business office.
- 4) We chose not to have a reduction in force but rather elimination by attrition, which has amounted to 100 positions, which saved \$1.3 million every year.
- 5) We didn't eliminate programs though we did eliminate two prep periods at the junior high (academic teaming).
- 6) We eliminated the staff by combining job responsibilities. We eliminated the position of Director of Warehouse and moved those responsibilities to custodial services.
- 7) We instituted a multi-year budget planning beginning in Oct. 2000 with Board Policy addressing Fund Balance by October 2005. We implemented a modified zero-based budget planning process. Every director and campus principals must justify their budgets. The Cabinet hears all requests.

**EDBS:** Obviously, we took a better look at revenue forecasting where our enrollments were going and making sure we came up with staffing formulas. We said we couldn't blindly say we think we need this many positions at this kind of



campus. We actually came up with different staffing formulas as they were tied to budget development. Based on your enrollment in the spring we will give you a projected staffing and you do not have to justify. If you want more than this tell us why you need it and justify. So our budget development has focused on looking at what above the formula they are requesting and why they want it. So that helped us focus on what are the things above some baseline that are being requested so that it could be an overwhelming task at just looking at 100 percent. Because sometimes you run out of time; you get caught in the details; you don't get a chance to look at the big picture. Give them a guide and focus on the above base allocations that are being requested. Of course, reducing staff through attrition is not what we preferred but that gave us the ability to say when a position became vacant; is this something that needs to be filled? That gave us the ability to start chipping away. When I arrived at the district I asked what is our financial system that we do our processing and data and what are capabilities of this system. My experience at another school district was with a more modern system. What I found in our district was a system that required intensive manual calculation outside the system. I felt to be staying on top of these figures that were a routine and cumbersome process. Somebody who had the ability to retrieve data from raw format and be able to make sense out of it through relational data system and even though I had the experience I did not have the time to devote to stay on top of that data. At least it was a tool. We had to build it into the budget and convince staff that there are options out there and you will

have to go through a learning curve. But it will mean that you will have a tool to make your job easier. It will be more automated, more decentralized and we will expect more from staff but it is a system that takes advantage of technology out there that has workflow profit. They can submit a purchase requisition for example, recruitment action and you can monitor through the financial HR system and anyone who submitted they know whose desk that is setting on. If all goes well, the superintendent can do all of the budget checks and go to the end and have a better financial HR system and it is true on the student side. If your budget is driven by how many students are in categories the system you are using is very cumbersome. If there are alternatives out there they may require some investment and training but if they are going to give the tools to stay on top of where your accounts are and they can facilitate you staying on top of your expenditures. We are currently going through training to different system away from system that had been used here for twenty-three years. We are going to something more “user friendly” and robust which is Skyward. This is way to have the data we need to stay on top of the monitoring required. They are expecting us to do more maintenance as far as submitting more stuff through the Internet so they can do their analysis in an automated fashion. If we are given more to do, without more revenue the only way that you are going to keep current or possible stay ahead of the curve is to have better tools to do your job.

**S.B.P. #2:** Revenue forecasting is the main thing for me. None of that other stuff was large scale that we didn't do. We had a little bit of staffing changes, teacher wise. The main thing was forecasting and realizing what we had to do.

**TEA Representative:** The superintendent must recognize there is a problem and listen to what the problem is and raise that concern to the board and then have the board recognize and say we have to do something about this. That is the key to turning it around. This is an ongoing process. Normally, it takes a district that is in this financial situation about three years to come out of it to bring it back to financial solvency where it is stable and solid and at that point that is a critical point in some cases more critical than at the bottom because at that point district as a whole wants to regress and return to the way it was when they were well to do. So the board thinks that we have money in the bank now we institute some of these programs; the very programs that took them down in the first place; the additional personnel for example; the cost the expense of new curriculum or going back and adding more classes; more courses and so it is the wise superintendent; and certainly the business manager and the board make people aware that folks the buffalo is gone; we can't go back; we are still going to be penny-tight and that is how we are going to operate from now on. There is significant community reaction; we have seen this time and again; where we get these calls they want to go back now, my board says we got money in the bank; now they want to have their own pet program.

*Utilizing TEA Tools*

**Interviewer:** How were the fiscal tools of the Texas Education Agency used in resolving the problem?

**S. #2:** Well, the FIRST was used as a guide because basically I already knew what the FIRST was going to have to produce when I joined the district in July of 2000. It wasn't in place but I already knew it and basically I used it as a guide to guide me on how many Para-professional support staff we had; how many teachers we needed; how many administrators, what percentage of the budget was going to instruction. All of those things were built into FIRST. So it was a guide that I used to get us to where we needed to go.

**EDBS:** The optimum fund balance goal, which was adjusted toward the FIRST criteria allowed the district to project towards the \$7 million range. We were right on the borderline. Even though we were half way there the people saw a positive fund balance and now you can relax all the stuff you have been doing. Seeing that indicator and knowing that you are not even in the range of having at least one month of operation in fund balance as that audit. That was saying to me that we need two and one half months. Here is a criteria and someone from the outside saying you are not where you need to be. So \$3 million may seem like a lot but when that first rating came out we were at \$800,000. I think this year we will be hitting the mark we want to be more ambitious and have two and one half months because we want to be more conservative given the profile of our district. If the funding formulas at the state change we don't anticipate being a district that

gains if anything, we will be a district that takes a few steps backward. Trying to keep in mind not what is immediate but what is out there on the horizon and being proactive approach and that is hard to sell when your fund balance is over \$1 million and your staffing levels are not what recent memories recall and they are having to do more with less. That was the biggest one from that rating system.

### Summary

Based on a through review of financial and audit reports, newspaper articles, written correspondence, and interviews with key informants, the following were found to be the circumstances immediately prior to and during the insolvency of the Uvalde Consolidated Independent School District:

- 1) There was increase in staffing while the district experienced a decline in student enrollment.
- 2) Overspending of an overpayment made to the school district by the state, which resulted in a negative fund balance account.
- 3) Errors in predicting Average Daily Attendance (ADA) for the school district, which translated in inaccurate revenue projections.
- 4) Difficulties in processing relational data in budgeting.
- 5) Communication between superintendent and school board.
- 6) There was a need for better and more accurate revenue forecasting.
- 7) Streamlining organization and management using highly qualified staff.
- 8) Stabilizing financial management.

The key factors identified by those interviewed as contributing to regaining fiscal solvency were the following:

- 1) Restructure the financial management's organization and hire a more qualified financial officer in terms of knowledge of accounting systems.
- 2) Adopting policies to prevent deficit budgeting and deficit budget amendments.
- 3) Implement procedures for data collection, review and submission to ensure the integrity of Public Education Information Management System (PEIMS) submissions.
- 4) Purchase of better computer system in order to better project revenues and staffing.
- 5) Better understanding of the implications concerning student enrollment changes.

## **CHAPTER V: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### Summary

This study described two school districts, which had experienced fiscal insolvency and have either become solvent or have made substantial progress toward regaining fiscal solvency. The study sought to answer the following research questions:

What were the factors that contributed to the districts fiscal insolvency?

What were the factors contributing to the districts regaining fiscal solvency?

Were the fiscal tools of the Texas Education Agency used in resolving the problem?

The data sources for this study included the application of descriptive financial ratios for each district, PEIMS data, semi-structured interviews; and a review of documents. The qualitative approach allowed for dialogue between the researcher and respondents and enabled the researcher to gain a deeper understanding of the fiscal problems of each school district. The researcher addressed the issue of construct validity by using multiple sources of evidence including PEIMS data, semi-structured interviews, audit reports, balance sheets, financial reports, school board minutes, and relevant newspaper articles to establish a chain of evidence. In addition, key informants were asked to review a draft copy of their cases for accuracy.

Reliability was addressed by using a case study protocol. Additionally, four descriptive financial ratios were applied to each district to further support the reliability of the study. Findings for the school districts included in the study were presented in

Chapter Four. The notion of Yin (1994) concerning construct validity is well served by the use of numerical ratios as a description of financial solvency and complements the anecdotal evidence of each case.

#### Cedar Hill Independent School District

Prior to the TEA ‘substandard’ rating, Cedar Hill Independent School District adopted budgets which did not reflect current district operations; had a lower than required reserve for economic uncertainties; allowed unmonitored purchasing; unapproved loans; and experienced greater than anticipated growth in both enrollment and spending. In addition, the district did not have a detailed budget calendar nor did it do long-range financial planning. There was also a lack of internal controls in accounting and a lack of position controls.

During the 2001-02 fiscal year, the Cedar Hill Independent School District replaced the superintendent and chief financial officer. The new leadership inherited a budget adopted for the 2001-03 FY that showed a beginning fund balance of a negative \$2,727,529. The superintendent and chief financial officer set in motion a plan that communicated the crisis to the school personnel and community stakeholders and reduced the deficit to \$1,061,422 by the next fiscal year.

The key factors identified by those interviewed as contributing to regaining fiscal solvency were: 1) the establishment of a system of internal controls, 2) conservative budgeting, 3) better revenue forecasting, 4) following the recommendations of the TSPR, 5) aligning budgeting and board policies, and 6) elimination of block scheduling. Additional key factors mentioned were careful financial planning, improved school board



communications, and the support of the board and the community for the projected goals of fiscal solvency.

Both the TSPR and the TEA ratings were helpful in resolving the fiscal problems of the Cedar Hill Independent School District. The comptroller's report and TEA rating furnished a clear and understandable approach to presenting the problem to the community. The school district furnishes an excellent example of recovery in terms of leadership, recognition of the problem(s) and communication in the budgetary process.

#### Uvalde Consolidated Independent School District

The Uvalde Consolidated Independent School District experienced several factors which conspired to produce the circumstances prior to the TEA 'substandard rating' of 2000-01 fiscal year. These factors included the lack of long range financial planning, declining student enrollment coupled with increases in staffing, spending of a TEA overpayment in an amount in excess of \$1,000,000, unmonitored capital spending and a lower than required reserve for economic uncertainties.

In addition, there was a lack of communication between the superintendent and the board/community regarding the financial situation of the district. There was also an overestimation of the growth of assessed valuation.

The key factors identified by those interviewed as contributing to regaining fiscal solvency by the Uvalde Consolidated Independent School District were the hiring of a new superintendent in 2000 who clearly recognized the fiscal problems of the district. In addition, an Executive Director of Business Services was hired who had experience in a larger district setting. These individuals were able to assemble a better financial model to

deal with better revenue forecasting, decreasing staffing through attrition, and the improved communication to the board/community of the complexities of the problem. Further factors included the institution of long range financial planning tied to board policies. Modified zero-based budgeting was instituted by the administration to furnish internal controls and eliminate the potential for negative fund balances in the future. This process addressed annual budgeting more efficiently at every level by requiring substantiation of expenditures.

### Conclusions

The following commonalities emerged from the data in the two cases:

1. Both districts failed to forecast revenues accurately. Additional insights for interpretation of demographics information and state funding formulas would be necessary coupled with better computer software to organize data.
2. Both districts overspent revenues in the general fund resulting in a negative fund balance. This practice placed both districts in the TEA 'substandard' rating.
3. There was a lack of internal controls in both districts. Neither district maintained a business office that was organized and dedicated to the mission of fiscal solvency.
4. Both districts are major employers in the areas that they serve. Staffing cuts were made through attrition in both districts. Fiscal solvency requires deep budget cuts. Since 80-85% of a school district's budget is spent on salaries and benefits, such deep budget cuts usually require reduction in force or the elimination of positions through attrition.

5. There was a lack of long range financial planning in each of the districts. Budget planning was an annual rather than an on-going process.
6. There was a lack of communication in each of the districts studied. Both districts experienced a lack of understanding of the problem and its ramifications internally and externally. The school board was not knowledgeable of the potential shortcomings of the overspending of revenues.
7. The prior superintendents had not demonstrated a clear understanding of the financial position of the school districts. They did not truly understand the relationship between student enrollment and staffing.
8. Board policies and procedures were not written to address financial goal setting.
9. Both districts experienced a need for computerized software system that would better facilitate the processing of relational data in terms of aiding in forecasting.

#### Warning Signs of Financial Distress

The two cases studied and the corresponding budgetary documents furnish a basis for the researcher to conclude the following conditions to be indicative of financial distress: (a) declining fund balances; (b) failure of internal controls in a school district; (c) board policies that are not updated regularly and do not coincide with administration's financial plans; (d) inaccurate revenue forecasting; (e) lack of a reserve for economic uncertainties or contingency funds; (f) a lack of financial reporting to the Board of Trustees; (g) lack of long or mid-range budget planning; (h) lack of fiscal leadership in the superintendency; (i) lack of knowledge of TEA funding formulas and (j) lack of communication to the Board and community of the fiscal ramifications and implications.

### Means to Successful Recovery

The researcher can conclude the following conditions to be favorable for a school district's successful recovery from insolvency: (a) leadership which was able to clearly identify the problems; (b) purchase of better computer systems which enabled better projection of revenues and staffing; (c) adopting policies which prevented deficit budgeting; (d) reorganization or restructuring of finance department; (e) obtaining competitive proposals for external audit services; (f) hiring an internal auditor; (g) hiring a highly qualified financial officer in terms of knowledge of accounting systems and (h) implementing procedures for data collection, review and submission to ensure the integrity of PEIMS submissions.

### Conclusions on the Utilization of TEA Fiscal Tools

The two cases studied provide a basis for the researcher to conclude the following concerning the utilization of the FIRST rating system: (a) it was used as a guide for future direction; (b) it furnished an optimum fund balance goal; and (c) it prompted community awareness of the severity of the school district's fiscal crisis.

### Conclusions on Decision Making Models

This study focused on school finance through the lens of three decision-making models. Financial insolvency represents a crisis situation for a school district. The impediments to success include time pressures, political pressures, conflicting information and uncertainty. School leaders must act within compressed time frames, high stakes environments, tough choices and unpredicted events. In both school districts

studied, the researcher can draw the following conclusions regarding these models and their implications through the information gathered.

The most difficult step for each school district was the accurate identification of the problem. The leaders through the reflective mathematical analysis of data that clearly diagnosed the problems accomplished this initial decision-making step. The skills and knowledge was not entirely intuitive, but rather largely dependent on the ability of leaders to generate rational alternatives, which explained choices to the board of trustees and other stakeholders. The rational approach did furnish the adequate framework from which to build measurable targets and monitor the economic progress of the school district. Furthermore, the leaders within these school districts were able to establish priorities that were validated and quantifiable through the use of the rational approach to budgetary decision-making coupled with the rationally grounded TEA fiscal tools.

The researcher contends that both the incremental and garbage can models did not provide the adequate infrastructure from which to diagnose the problems or facilitate change in an environment of financial insolvency.

#### Recommendations

It is recommended to policy-makers and local boards of education that:

- 1) Boards of Trustees monitoring their adherence to policy and administrative regulation in terms of incurred debt, budget controls and staffing.
- 2) Boards of Trustees furnishing explicit rationale and revenue sources to justify staffing and personnel raises.

- 3) Boards should direct the superintendent to take action so that ADA is more accurately estimated.
- 4) Board of Trustees ensuring that the integrity of the budget as adopted in the open meeting is carried out as approved.
- 5) Boards monitoring closely declining revenues and act accordingly in terms of budgeting.
- 6) Boards requiring the administration to develop mid- to long-range financial plan to be updated annually that includes all known financial commitments.
- 7) Boards carefully reviewing audit recommendations and monitoring their implications by the Superintendent.
- 8) Boards requesting reports and/or balance sheets highlighting the financial position of the district from the School Business Official on a regular monthly basis.
- 9) Boards are furnished with periodic review of cash flow statements.

It is recommended for Administrators, Superintendents/School Business

Officials that:

- 1) Superintendents ensuring policies and procedures are kept up to date and formatted for use by the district staff.
- 2) Superintendents adhering to internal management procedures and chain of command.
- 3) Superintendent/School Business Officials furnishing workshops on budget preparation and procedures for principals.

- 4) Superintendents recognizing their responsibility for accurate prediction of district revenues through careful estimation of student enrollment and assessed valuation utilizing a historical approach.
- 5) Superintendent/School Business Officials providing monthly updates to the Board of Trustees concerning the financial condition of the school district.
- 6) Continued efforts in enhancing communication, which specifically opens channels of communication between the Business Office and other district staff.

#### Recommendations for Further Research

It is recommended that:

- 1) Further research be conducted utilizing this research design and methodology with other districts in similar contexts with different enrollments to furnish generalization.
- 2) Research be conducted which examines school districts considered both economically and academically “substandard achievement” ratings in terms of factors, which may be interrelated.
- 3) Research be conducted which examines or anticipates the impact on school districts of changes in the way schools are funded in a state.

**APPENDIX A**

Figure: 19 TAC §109.1002(b)

**School FIRST - Rating Worksheet**

School Year \_\_\_\_\_

Fiscal Year Ended June 30, \_\_\_\_\_ Or August 31, \_\_\_\_\_

County District # \_\_\_\_\_

District Name : \_\_\_\_\_

Check The Appropriate Box Below	
Yes	No

**Critical Indicators**

1	Was Total Fund Balance Less Reserved Fund Balance Greater Than Zero In The General Fund?		
2	Were There No Disclosures In The Annual Financial Report And/Or Other Sources Of Information Concerning Default On Bonded Indebtedness Obligations?		
3	Was The Annual Financial Report Filed Within One Month After November 27th or January 28th Deadline Depending Upon The District's Fiscal Year End Date (June 30th or August 31st)?		
4	Was There An Unqualified Opinion In Annual Financial Report?		
6	Did The Annual Financial Report Not Disclose Any Instance(s) Of Material Weaknesses In Internal Controls?		

**Fiscal Responsibility**

6	Was The Percent Of Total Tax Collections (Including Delinquent) Greater Than 98%?		
7	Did The Comparison Of PEIMS Data To Like Information In Annual Financial Report Result In An Aggregate Variance Of Less Than 4 Percent Of Expenditures Per Fund Type (Data Quality Measure)?		
8	Were Debt Related Expenditures (Net Of IFA And/Or EDA Allotment) Less Than \$770.00 Per Student? (If The District's Five-Year Percent Change In Students Was A 2% Increase Or More, Or If Property Taxes Collected Per Penny Of Tax Effort Were More Than \$100,000, Then Answer This Indicator Yes)		
9	Was There No Disclosure In The Annual Audit Report Of Material Noncompliance?		
10	Did The District Have Full Accreditation Status In Relation To Financial Management Practices? (e.g., No Master Or Monitor Assigned)		

**Budgeting**

11	Was The Percent Of Operating Expenditures Expended For Instruction More Than 54%?		
12	Was The Aggregate Of Budgeted Expenditures And Other Uses Less Than The Aggregate Of Total Revenues, Other Resources and Fund Balance In General Fund?		
13	If The District's Aggregate Fund Balance In The General Fund And Capital Projects Fund Was Less Than Zero, Were Construction Projects Adequately Financed? (Were Construction Projects Adequately Financed Or Adjusted By Change Orders Or Other Legal Means To Avoid Creating Or Adding To The Fund Balance Deficit Situation?)		
14	Was The Ratio Of Cash And Investments To Deferred Revenues (Excluding Amount Equal To Net Delinquent Taxes Receivable) In The General Fund Greater Than Or Equal To 1:1? (If Deferred Revenues Are Less Than Net Delinquent Taxes Receivable, Then Answer This Indicator Yes)		

**Personnel**

15	Was The Administrative Cost Ratio Less Than The Standard In State Law?		
16	Was The Ratio Of Students To Teachers Within The Ranges Shown Below According To District Size?		
17	Was The Ratio Of Students To Total Staff Within The Ranges Shown Below According To District Size?		

**Cash Management**

18	Was The Total Fund Balance In The General Fund More Than 50% And Less Than 150% of Optimum According To The Fund Balance and Cash Flow Calculation Worksheet in the Annual Financial Report?		
19	Was The Decrease In Undesignated Unreserved Fund Balance Less Than 20% Over Two Fiscal Years? (If 1.5 Times Optimum Fund Balance Is Less Than Total Fund Balance In General Fund Or If Total Revenues Exceeded Operating Expenditures In The General Fund, Then Answer This Indicator Yes).		
20	Was The Aggregate Total Of Cash And Investments In The General Fund More Than \$0?		
21	Were Investment Earnings In All Funds More Than \$15.00 Per Student?		
<b>Total Yes And No Answers</b>			

**Determination Of Rating**

A.	Did The District Answer No To Indicators 1, 2 Or 3? OR Did The District Answer No To Both 4 And 5? If Answered No To Either, The District's Rating Is <b>Substandard Achievement</b>	Check Box Below For Number Of No Answers
B.	Determine Rating By Applicable Range For The Number Of Indicators Answered <b>No</b>	
	Superior Achievement	
	Above Standard Achievement	
	Standard Achievement	
	Substandard Achievement (If Answered No To 7 Or More Indicators OR If Answered No To Indicators 1, 2 Or 3; OR Answered No To Both 4 And 5)	One Default Indicator

For Questions Call The Division Of School Financial Audits At (512) 483-9095

Indicator 16	Ranges for Ratios	
	Low	High
District Size - Number of Students Between		
<500	7	22
500 - 999	10	22
1000 - 4999	11.5	22
5000 - 9999	13	22
=>10,000	13.5	22

Indicator 17	Ranges for Ratios	
	Low	High
District Size - Number of Students Between		
<500	4	14
500 - 999	5.5	14
1000 - 4999	6	14
5000 - 9999	6.5	14
=>10,000	6.6	14

Completed By: \_\_\_\_\_ Date: \_\_\_\_\_

Notes: \_\_\_\_\_

May 2003



APPENDIX B

**David L. Simmons**

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HOME (830) 606-1095 • WORK (830) 627-6009 • FAX (830) 627-6001  
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March 6, 2004

RE: Research Study

Superintendent  
Uvalde CISD  
1000 N. Getty St.  
Uvalde, TX 78801

Dear Superintendent ,

The purpose of this correspondence is to request your permission to conduct a research study involving yourself and several other stakeholders in your school district. The research project is designed as a case study of school districts that have emerged from 'substandard' financial ratings by the Texas Education Agency. I am a candidate for a doctoral degree in Educational Administration at the University of Texas at Austin. Your district was selected as a potential participant because it met the criteria established for this research study as a district that has successfully emerged from fiscal distress.

The following research questions will be addressed in the study:

- 1) What were the factors that led to the districts' fiscal insolvency?
- 2) What were the factors contributing to the districts' regaining solvency?
- 3) How were the fiscal tools of the Texas Education Agency used in resolving the problem?

In order to answer these questions two to three districts will be interviewed. Examples of stakeholders to be interviewed for each case will include the school district superintendent, business manager, and a school board member. Each participant will be asked to agree to a one-hour interview.

In addition to the interviews, documents from the previous three years will be collected. These documents might include the Academic Excellence Indicator System reports, FIESTIER information, School District Summary of Finances, tax information, debt information, School FIRST reports, annual audits, school board minutes, and other relevant information.

Your assistance in this research endeavor would be greatly appreciated. Although there will be limited benefit to your district because of this research, the benefits to other school districts could be considerable as this research will attempt to bring out the best practices in finance and accounting measures. If you have any questions or concerns I would be glad to address them. In addition, I can give you the contact information for my committee members who could also address any concerns. My committee consists of Mike Thomas, Nolan Estes, Catherine Clark, Martha Ovando, and Lisa Cary. I will be contacting you in the near future by phone to discuss your participation in this study.

Sincerely,

David Simmons  
Doctoral Student  
University of Texas at Austin

APPENDIX C

**Cedar Hill ISD  
1994-95 to 2002-03 Budget**

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03
Total Revenue	\$24,236,641	\$26,771,184	\$24,403,721	\$27,791,558	\$28,333,027	\$34,103,655	\$33,710,895	\$43,243,639	\$48,017,369
Total Expenditures	\$23,072,383	\$26,911,076	\$24,877,101	\$28,373,409	\$29,187,361	\$32,949,088	\$36,361,719	\$43,222,518	\$48,815,809
Increase (Decrease) in Fund Balance	(\$278,967)	(\$644,140)	\$380,516	\$498,241	(\$114,020)	(\$1,091,611)	(\$1,655,556)	(\$1,666,107)	(\$180,345)
Begin Fund Balance*	\$1,155,214	\$876,247	\$232,107	\$612,623	(\$114,382)	\$362	(\$1,071,973)	(\$2,727,529)	(\$1,061,422)
Ending Fund Balance*	\$876,247	\$232,107	\$612,623	(\$114,382)	\$362	(\$1,071,973)	(\$2,727,529)	(\$1,061,422)	\$881,077

Source: TEA, PEIMS 1994 through 2003

\* = Undesignated Fund Balance

**Uvalde CISD  
1994-95 to 2002-03 Budget**

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03
Total Revenue	\$24,731,425	\$29,368,842	\$26,846,574	\$28,762,988	\$30,258,518	\$32,169,752	\$32,865,452	\$32,158,345	\$33,351,758
Total Expenditures	\$24,319,266	\$27,761,553	\$26,284,292	\$28,871,301	\$30,949,897	\$31,521,416	\$32,674,534	\$32,123,818	\$33,291,604
Increase (Decrease) in Fund Balance	(\$915,415)	\$653,521	\$959,399	(\$842,593)	(\$1,612,210)	\$122,499	\$151,653	\$578,550	\$1,466,367
Begin Fund Balance*	\$1,929,415	\$1,014,000	\$1,667,521	\$2,626,920	\$1,784,327	\$172,117	(\$49,618)	\$201,268	\$779,818
Ending Fund Balance*	\$1,014,000	\$1,667,521	\$2,626,920	\$1,784,327	\$172,117	(\$49,618)	\$201,268	\$779,818	\$2,246,185

Source: TEA, PEIMS 1994 through 2003

\* = Undesignated Fund Balance

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