

SHAKER HEIGHTS CITY SCHOOL DISTRICT
Shaker Heights, Ohio

Finance & Audit Committee
Report

December 2002

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EXECUTIVE SUMMARY

The system for funding public schools in Ohio today continues to rely heavily on the local property taxpayer. Under Ohio Law, school districts must maintain a balanced budget. Other state laws, namely House Bill No. 920 (“H.B. 920”), enacted in 1976, have the effect of preventing any increase in tax revenues when property values rise. This requires school districts to pass levies to raise additional revenue. This is particularly onerous for mature residential communities such as Shaker Heights, where there is very little land available for new development, and relatively little commercial property to help absorb the tax burden. To compound matters, other state-level developments already enacted will reduce future school district tax revenues.

At the same time that tax revenues are frozen, school expenditures increase. Some of these increases are mandated by statute or contract, while other increases are due to inflationary forces existing elsewhere in the economy, notably in health care. As a result, a school district has the choice of going to the voters for a new levy or implementing spending cuts that could jeopardize the outstanding educational programming that has historically been provided by the Shaker Heights City School District (“the District” or the “Shaker Schools”).

One does not have to look far to find objective evidence of the quality of the Shaker Schools:

- The graduation rate for Shaker Heights High School is 99.1%;
- On average, approximately 90% of Shaker graduates enroll in colleges and universities across the country
- The average SAT exam scores and the number of Advanced Placement courses offered to its students compare very favorably to those of neighboring districts; and

- Each year, an average of 14% of the Senior Class are recognized as either National Merit, National Achievement, or National Hispanic scholars, compared with only 2% of high school seniors nationally who earn such honors.

The District cannot reasonably expect additional support from the State of Ohio to help finance programs. While the December 11, 2002 Ohio Supreme Court ruling in the *DeRolph* case requires the State to revamp its system for financing education, it is not anticipated that this decision will result in any additional resources in the near term.

Responsible stewardship requires that the District pursue the dual objectives of financial balance and very high quality educational programs. For this reason, the Finance & Audit Committee has concluded that the District should place an operating levy on the ballot in 2003. The following report details the Committee’s conclusions pertaining to this important issue.

I. INTRODUCTION

Assuring that its schools have necessary financial resources is one of a local board of education's most important responsibilities. To meet this responsibility, the Shaker Heights Board of Education conducts a continuous assessment of both current revenues and expenditures and projections for the future.

In October 2002, the Shaker Heights Board of Education appointed a Finance & Audit Committee consisting of nine members, including two members of the Board of Education, to help assess the District's financial needs. The members of the committee were selected because of their broad range of expertise in accounting, economics, finance, public finance, law, and higher education. All are District residents. Brief biographical sketches of the committee members are included in the appendix of this report.

The Committee was charged with the following tasks:

- Review the forecast assumptions made by the District Treasurer;
- Study the financial projections and examine related documents concerning the District's finances; and
- Conclude as to the necessity of placing an operating levy on the ballot in 2003.

Consistent with its charge, the Committee met in November and December to study the District's financial projections and review related financial information. The Committee members were provided with significant amounts of data about the sources and uses of district funds as well as background information about school finance in Ohio. The following sections summarize the Committee's observations and conclusions.

II. DISTRICT OVERVIEW

A. The Board of Education and Administration

The Board of Education of the Shaker Heights School District (the "Board") is a political and corporate body charged with the responsibility of

managing and controlling the affairs of the District, and is, together with the School District, governed by the general laws of the State of Ohio (the "Ohio Revised Code"). The Board is comprised of five members who are locally elected to overlapping four-year terms. The Board elects its President and Vice President annually, and appoints two officials: the Superintendent, who serves as the Chief Executive Officer, and the Treasurer, who serves as the Chief Financial Officer.

B. The School District and its Facilities

The District is located in Shaker Heights, Ohio, Cuyahoga County. The District operates five elementary schools (K-4), one upper elementary school (5-6), one middle school (7-8), one high school (9-12), and a pre-kindergarten Early Intervention Program at the Shaker Family Center. The District's four support facilities include an administration building, transportation center, warehouse and maintenance vehicle garage, and a media and technology services facility. The District's facilities include 900,000 square feet in buildings and 95 acres of grounds. The District's 47 buses transport in excess of 4,000 public and private students per day.

The District covers approximately 7.5 square miles, including all of the City of Shaker Heights and a portion of the City of Cleveland in the Shaker Square area, and is located approximately ten miles southeast of downtown Cleveland.

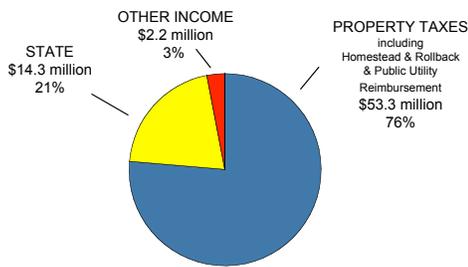
C. District Employees

The District's instructional and support facilities are staffed by 286 classified (non-teaching) employees, 490 certificated full-time and part-time teaching and tutoring personnel, and 36 administrators who provide services to 5,600 students. The District's teachers and certain educational specialists are represented by the Shaker Heights Teachers' Association ("SHTA"). The District's teaching staff average sixteen-plus years of experience. Classified employees of the District are represented for collective bargaining purposes by two unions, Ohio Association of Public School Employees (OAPSE), Local #149 (secretarial-clerical), and National Conference of Firemen and Oilers, Local #200 (custodial, maintenance, transportation and cafeteria staff).

D. District Revenues

The two main sources of revenues for school districts in Ohio are local property taxes and State support through the State Foundation program. The District’s revenues for fiscal 2001-02 included approximately \$53.3 million from property taxes (including the state reimbursement for Homestead and Rollback and Public Utility reimbursement payments) which represented 76% of the District’s General Fund revenues. The State contributed \$14.3 million, or 21% of total General Fund revenues.

General Fund Income 2001-02



Total = \$69.8 million

Of the District’s property tax revenues, approximately 78% or \$41 million are derived from the taxation of residential real estate (as opposed to the taxation of either commercial real estate or commercial personal property). This heavy reliance on residential property taxes is due to the limited amount of commercial property that exists within the District boundaries.

E. District Expenses

In all school districts the largest category of operational expenditures is personnel. Historically, in Ohio 80% to 85% of school district budgets consist of salaries and related employee benefits. For the fiscal year ending June 30, 2002, salaries and benefits approximated 83% of total general fund expenses in the District.

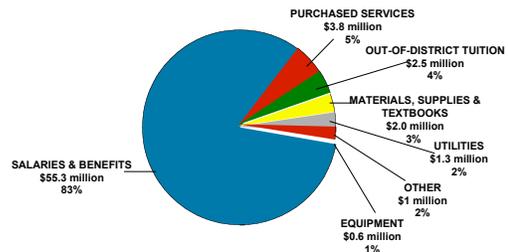
Negotiated collective bargaining agreements determine salary and related fringe benefit payments for nearly all District employees. The current contracts, which expire in fiscal 2004, call for annual 3.3% cost of living adjustments in addition to annual experience and degree level increases. The two major fringe benefit costs are

the state-mandated 14% of salaries for retirement contributions, and health insurance. The cost of health insurance has skyrocketed over the past few years and this high rate of inflation plays an important role in projecting future spending increases. Although many in the healthcare industry predict higher cost increases, the District has budgeted only an annual 10% net increase during the five-year forecast period. In addition, the Medicaid/Medicare tax expense, while only 1.45% of salaries, increases each year as salaries go up and as more of the District’s workforce is subject to the tax.

Additionally, Federal and State regulations require certain mandated services, primarily special education, which have become significant cost factors for the District. Special education services are provided both within the District and externally through cooperative agreements with other educational institutions. All special education costs, especially out-of-district tuition costs, continue to soar. Not only does the cost of delivering such services continue to outpace the general inflation rate, but the proportion of students requiring special education is rising both locally and nationally. Such costs make up 13.7% of the General Fund budget in fiscal 2002 as compared to 10.8% in fiscal 1996.

As discussed in Section IV.,B., new state and federal mandates also place additional financial burdens on the District. It is anticipated that these costs will continue to rise for some time into the future.

General Fund Expenses 2001-02



Total = \$66.5 million

F. District Capital Outlays

The District has historically funded its major capital improvements and repair needs through the issuance of taxpayer approved bonds. The last two bond levies were approved in 1996 (\$12.7 million) and 1990 (\$10 million). The remaining outstanding balance of these general obligation bonds is serviced by a dedicated property tax currently approximating 2.9 mills.

The District partially replenished its depleted capital fund in fiscal 2002 with the \$2.7 million proceeds from the sale of 46,666 shares of Anthem stock received when the District’s primary health insurance carrier demutualized (converted from a mutual to a stock corporation). The District contemplates continuing the practice of utilizing either bond or permanent improvement levies as a means for financing its future capital needs. The next such capital levy is not anticipated to occur until sometime in 2004 or 2005.

III. NEIGHBORING DISTRICT COMPARISONS

In order to put expenditures and revenues in perspective, it is useful to compare the Shaker District with others. Section A3. of the Appendix includes three tables which list a variety of data for the Shaker Schools and a neighboring group of school districts.

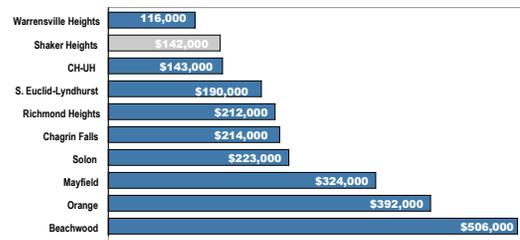
Section 1 of Table 1 indicates that Shaker Heights will spend \$12,384 per pupil in fiscal year 2003, placing it fifth out of the ten comparison districts. Nevertheless, starting teacher salaries, a key measure of the District’s ability to attract new talent to the schools, remain very competitive. As reported in Section 2 of Table 2, Shaker pays its beginning bachelor-degreed teachers \$33,418 and beginning master-degreed teachers \$35,754, third and fourth highest, respectively, when compared to the neighboring districts.

Although Shaker’s average teacher salary is third highest (Section 2, Table 2), its student/teacher ratio (Section 1, Table 2) of 14.8 equals the state-wide average, with only two other districts in the comparison group having higher ratios. Section 3 of Table 1, which breaks down the composition of

expenditures across broad categories, indicates that the figures for Shaker are roughly in line with those in neighboring districts. It should be noted that the education and experience levels of teachers vary significantly from district to district, and this has a direct impact on the per pupil expenditure level.

Section 1, Table 1 includes the five-year compounded growth rate of expenditures during the fiscal 2002 through fiscal 2007 period. The Committee believes that Shaker’s 4.8% compounded annual growth rate is quite reasonable, given the projected rates of increase in salaries, benefits and other expenditures discussed in the previous section. Furthermore, it compares favorably with the other districts in the group.

Taxable Value per Pupil 2001



Source: Ohio Department of Taxation

The per pupil property valuation (Section 1, Table 1) reflects a district’s property wealth and its tax collecting capability. Shaker’s per pupil valuation is second to the bottom with respect to the comparison group. This means that in order to generate per pupil revenues comparable to those of most neighboring communities, Shaker must have higher rates of taxation. For example, one mill in Beachwood yields the equivalent of 3.6 mills in Shaker (Beachwood per pupil \$505,982 ÷ Shaker per pupil \$141,676 = 3.6).

The first Section of Table 3 looks at various measures of school performance. Shaker’s score on the state-mandated report card for fiscal 2001 is 21 (with a rating of “effective”), which was a significant improvement from the previous score of 17 (with a rating “continuous improvement”) in 2000. While the District remains committed to improvement in report card scores, no single measure adequately captures all the dimensions

along which school systems must perform. For this reason, high school graduation rates, college attendance rates, average SAT exam scores, the number of Advanced Placement course offerings, and the number of National Merit Finalists are also included in the table for comparison purposes. In most of these categories, Shaker ranks at or near the top of neighboring districts.

The second Section of Table 3 presents the demographic characteristics of the student populations. We find that the percent of students having disabilities is roughly comparable across comparison districts. The notable exception to this pattern is Mayfield, which has programs that attract disabled students from other districts, including Shaker Heights.

The final demographic breakdown in Section 2, Table 3 concerns racial and ethnic groups. The vast majority of students in Shaker fall into either the African American or White categories. Indeed Shaker Heights (together with Cleveland Heights/University Heights, Richmond Heights, and Warrensville Heights) has a majority of “minority” students. Shaker Heights has gained national prominence for its various initiatives and achievements in building a school system that promotes ethnic and racial diversity as well as academic excellence. These achievements have been and continue to be a source of pride for our community.

IV. SCHOOL FINANCE ENVIRONMENT

A. State Funding

The core principle in Ohio’s approach to school financing is “shared responsibility.” Under this doctrine, the State provides funding in excess of what a local 23 mill property tax generates, up to a maximum per pupil amount. The formula for determining the State’s share has three elements: 1) the number of students in the school district, 2) the total per pupil cost of providing an “adequate” education, and 3) the amount of money provided by a local community property tax of 23 mills.

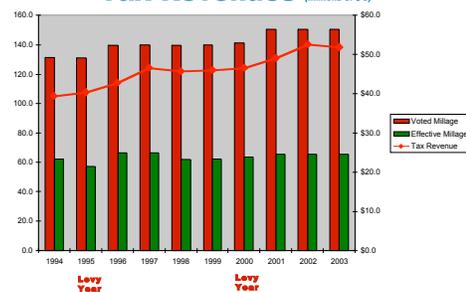
The number of students in a school district is based on enrollment counts during the first full week of

October. The cost of providing an “adequate” education is determined by the State and was set at \$4,814 per pupil (the “per pupil amount”) for fiscal year 2002. Thus, annual state funding is determined by multiplying the “adequate” education per pupil amount by the number of school district students, and subtracting the calculated amount of revenue generated by a local property tax of 23 mills. The State funds this difference.

This “shared responsibility” formula results in substantial differences in the proportion of school funds provided by the State. Because Shaker relies heavily on property taxes, the District received about 40% of the per pupil amount in fiscal 2001-02 from the State. Shaker Heights, however, spends more than twice the “adequate” education per pupil amount. Consequently, the State contributes only about 21% of the District’s revenues.

House Bill 920, which became law in 1976, prevents increases in property values from causing an increase in property tax revenues. If, during the triennial reappraisal/update process, the value of existing properties increases, then the millage rate is reduced so as to assure that total tax revenues remain fixed. This new lower tax rate is called the “effective millage.” As the accompanying figure shows, tax revenues are flat until a new levy is passed. In other words, when property owners vote for a levy, they are voting for a continuous fixed dollar amount rather than for a set number of mills.

**Effect of House Bill 920:
Voted & Effective Millage vs.
Tax Revenues** (millions of \$’s)



Although the majority of property taxes in Shaker benefit the school district (about 71.6% in calendar 2002), the total Shaker property tax bill also

includes taxes that are assessed by the City (10.9%), the County (12.5%) including RTA and others, and other entities (5%) such as the Library and the Metroparks. Because the reduction impact of H.B. 920 applies primarily to school districts, any increase in the property tax bills resulting from assessed value increases does not benefit the schools, but instead goes to the entities that are not affected by H.B. 920. Additionally, these other entities periodically place levies on the ballot, which, if passed, also increase residents' tax bills, the proceeds of which do not go to the school district. Only through a new tax levy can school districts generate additional property tax revenues.

The end result of H.B. 920 is that District revenues cannot automatically increase with the general rate of inflation. Consequently, the district's revenue stream remains flat over the years between levies, while its expenses continue to rise. In order to remain fiscally solvent, the District is forced to submit to its residents periodic requests for an increase in property taxes.

B. Accountability Initiatives

School Legislation:

Since the late 1990's, significant State legislation placed new burdens upon school districts throughout Ohio. House Bill 412 requires districts to allocate a set percentage of their revenues to be spent on textbooks and other instructional supplies, capital repairs and maintenance, and on establishing a rainy day reserve. Senate Bill 55 mandated that fourth-graders be held back if they do not pass the reading portion of the fourth-grade proficiency test. Although this hold-back provision was subsequently eliminated, other provisions including increased graduation and additional testing requirements continue to impose costs on the District.

The financial impact of the federal "No Child Left Behind" act is hard to assess, but additional testing and continuous improvement requirements are likely to impose additional costs on the District in the future.

C. Loss of Tax Revenues

Electric & Natural Gas Utility Deregulation:

Two bills enacted by the 123rd General Assembly reduced the assessment rates for some of the

tangible personal property of electric utilities and all tangible personal property of gas utilities. The resulting loss of revenues is estimated to be \$300 million state-wide. School districts are being reimbursed for these losses for a five-year period beginning in calendar 2002, with possible reimbursement in the subsequent ten years. These reimbursement payments began in early 2002. After the reimbursement period (expected to be after five years for the Shaker Schools), the \$6.6 million assessed value reduction will result in an annual revenue loss of \$946,000 in current tax dollars. The District will have to make up these losses through other revenue sources.

Repeal Of Inventory Property Tax:

In mid 1999, the State Assembly approved legislation that repealed the inventory portion of the personal property tax. Under the phase-out plan, the current assessment rate of 25% will be reduced 1% per year over a 25-year period. Once the phase-out is complete, the District will lose approximately \$500,000 annually in current tax dollars.

D. Legal Developments

State Funding Lawsuit (DeRolph Case):

The *DeRolph vs. Ohio* lawsuit claimed that the State's educational funding system failed to provide a thorough and efficient system of common schools as called for in the Ohio Constitution. The Perry County Common Pleas Court Judge ruled in favor of the plaintiffs in 1994, and the suit has been in the courts ever since. On December 11, 2002, the Ohio Supreme Court affirmed its earlier ruling, upholding the Perry County ruling. The ultimate disposition of the issues raised in *DeRolph* is at present, unknown. For this reason, the projections do not include any additional money coming to the District as a result of the final resolution of *DeRolph*.

Vouchers and Community Schools:

Public school systems face a potential loss of students and revenues from voucher programs (under which state funds are used to pay private school tuition) and community schools, state funded schools established outside the confines of traditional school systems in order to implement novel educational approaches and strategies. Although the U. S. Supreme Court found that

Ohio's voucher plan was constitutional, the community school program in Ohio has a greater impact on District finances. Currently, the funding for community schools is taken from the public school of residence. As a consequence, the Shaker Schools experience an annual resource drain via the State funding formula amounting to nearly \$100,000.

V. RESPONSIBLE STEWARDSHIP

A. Cost Containment Efforts

Responsible stewardship requires that the Board continually press for finding savings in the school budget that do not influence the quality of educational programs. Indeed, the achievement of cost efficiencies is one of the performance measures the Board uses in its annual evaluation of the Superintendent and Treasurer. Some examples of how the District has contained costs are:

- o In 1995, the Board of Education unilaterally adopted cost containment caps that limit the total growth in expenditures to a pre-determined formula amount based on the rate of consumer price inflation. These spending caps were renewed in 2000, and the District has successfully operated under spending limits since then.
- o The District has continuously monitored its health care benefit costs, and as a result the District added a Preferred Provider Organization choice for its employees. This option has a lower cost structure than the traditional comprehensive plan. Estimated annualized savings from this change amount to \$500,000.
- o The District began electing a contingent premium option available from its primary health insurance carrier, which enabled the District to save in excess of \$300,000 for fiscal 2001.
- o The District played a lead role in establishing a prescription drug consortium for governmental entities, which saves the District an estimated

\$75,000 per year by negotiating better discounts.

- o The District participates in the retrospective rating program for its workers' compensation requirements, and by so doing achieves substantial savings in premiums from 17% to 20% on an annual basis. Additionally, for the 1991, 1992, 1993, 1999, and 2000 workers' comp retrospective years, the District has saved a cumulative amount approximating \$550,000 (excluding any interest earned on the set-aside funds during the intervening years) by participating in the retro plan versus the premium-based plan offered by the Bureau of Workers' Compensation.
- o The District participates in a purchasing consortium of school districts that leverages high volume to win reduced prices from suppliers. The District uses the consortium to purchase energy (including electricity and natural gas), insurance (including liability, auto, and boiler policies) and telecommunications program. Additionally, the District acquires such large, commodity items as school buses through the consortium. Estimated annual savings resulting from the District's participation in the consortium range from \$155,000 to \$200,000.

B. Pursuit of Outside Funding

The District has aggressively pursued outside funding through federal, state, and foundation grants averaging about \$2 million per year. The District has been very successful at obtaining specialized grants, including over \$600,000 from the Cleveland and George Gund Foundations for expanded efforts to enhance minority student performance in the District.

The District enjoys a unique relationship with the Shaker Schools Foundation, a Section 501(c)3 nonprofit organization established with the sole purpose of benefiting the Shaker Heights City Schools. The Foundation disburses over \$15,000 annually in enrichment grants and student awards. Additionally, through the annual "Night for the Red & White" fund-raising formal event, the District schools have received annual payments

averaging nearly \$100,000 earmarked to fund building level technology or arts activities.

The District has sought and received other sources of revenue including a cumulative \$345,000 of E-Rate funds. E-Rate is a federal telecommunication subsidy payment instituted in the late 1990's dedicated for educational institutions.

Additionally, the District has aggressively pursued special education cost reimbursement avenues including Medicaid reimbursement under the Community Alternative Funding System (CAFS) and Ohio Department of Education Catastrophic Aid reimbursement programs, as well as the excess cost billing alternative for costs incurred on behalf of non-residential student enrollees. Such special education reimbursements average \$550,000 annually.

C. Academic Initiatives

With the support of faculty, parents, and local residents, our students continued to excel in academics, the arts, athletics, and community service. On average, 14 percent of the senior class at Shaker High School earned honors in the National Merit and National Achievement scholarship competitions, compared with 2 percent nationally. This high rate of success places Shaker near the top of Ohio schools.

Roughly 33 percent of eligible students at Shaker Heights High School take one or more Advanced Placement classes, compared with about 8 percent statewide. Based on their outstanding performance on the national Advanced Placement examinations, 83 Shaker students were named AP Scholars in September 2002. In May 2002, 294 sophomores, juniors, and seniors took 665 AP examinations, with 88 percent earning a score of 3 or higher, which usually is sufficient to earn college credit.

Shaker students continue to be sought after by colleges. More than 40 members of the Class of 2002 (over 12 percent) were accepted early into their first-choice colleges, including some of the most selective in the nation. About 90 percent of the graduating seniors plan to attend college after graduation.

Teams and individual students win numerous other awards in music, foreign language, the fine and performing arts, mathematics, and science. The following are just a few highlights from 2002:

- o Twenty Shaker students won 28 awards at the annual Scholastic Art Competition, with two artists' work advancing to the national competition in New York and three selected for display in Columbus.
- o Forty-five vocal music and orchestra students participated in the Ohio Music Educators' Association competition, with all 45 earning marks of Superior or Excellent.
- o Shaker students won 14 awards at the regional History Day competition -- the most in recent memory -- with 21 Shaker students qualifying for the state competition and eight going on from there to nationals in June.
- o The Middle School's Math Counts team placed second in the Regional Math Counts Competition in February and went on to compete in a state tournament in Columbus in March.
- o A five-member team from the Shaker Heights High School economics program finished first in the regional Federal Reserve Challenge, bringing Shaker its fourth regional title in as many years.
- o More than 200 Shaker students won honors on national foreign language examinations. In Latin, perfect scores were earned by one Middle School student and one High School student.

Year-in and year-out, our student athletes achieve outstanding interscholastic success, while groups such as student council, Student Group on Race Relations, and Youth Ending Hunger involve many Shaker students in helpful community service activities. The list of accomplishments goes on and on.

Helping each student reach his/her potential academically continues to be the paramount goal of the District. Building on the adoption of the Continuous Improvement Plan and the National School Boards Association's achievement initiatives, student achievement issues remain a major focus of the Board, with formal

presentations made at regular and special Board meetings.

Recognizing the benefits of technology in the classroom, additional investments have been made to enhance Shaker-Net, the District's computer network. The network currently consists of 25 servers and approximately 1,100 client machines on a network of 12 buildings. All district machines in laboratories and libraries have been re-imaged to enhance reliability and security. Shaker-Net continues to grow in terms of both staff usage and educational applications.

The District continues to study, plan, and implement instructional initiatives aimed at improving the academic achievement of all students. Current instructional initiatives include early intervention, after-school tutoring and an enhanced summer school program; an enhanced kindergarten resource program; an intensified focus on literacy and mathematics instruction; increased efforts to help students prepare for the Ohio Proficiency Tests; the expansion of a team teaching approach at the secondary school level; efforts to increase parental and community involvement; highly focused professional development activities and collaboration with the City of Shaker Heights, the Shaker Heights Public Library, and nonprofit community agencies concerned with the welfare of youth.

Continuous Improvement Plan:

In an ongoing effort to enhance the effectiveness and efficiency of the School District, staff members developed a Continuous Improvement Plan (CIP) for the Shaker Heights City Schools. The CIP is a document used to guide a school district in the process of achieving and measuring substantial improvement in educational performance. Input for this document came from the Board of Education, business representatives, students, parents, faculty members, and residents of the Shaker Heights community. The CIP identifies seven key areas for improvement: curriculum/instruction, academic achievement, assessment/evaluation, professional development, student services, facilities/environments, and parent/community involvement. It includes mission and vision statements for the School District along with priority areas, performance goals, strategies,

individuals responsible, timelines, and funding sources. The Continuous Improvement Plan was presented to the Board of Education, posted on the School District's website and made available to interested members of the community.

Curriculum Writing & Instructional Planning:

Each summer, many teachers devote their energies to improving instruction throughout the School District. Instructional planning and curriculum writing are undertaken in the fields of mathematics, English/language arts, science, social studies, art, health, library, parent involvement, special education, senior projects, foreign language, home economics, interdisciplinary instruction, music, technology, program planning, conflict resolution, reading, marketing education, student achievement, proficiency intervention and theater. Continuing emphasis is placed on professional development, including efforts to refine and expand effective teaching practices.

Tripod Project:

In 2000, the District received a total of \$286,500 from the Cleveland and George Gund Foundations to enhance overall student performance through implementation of the Tripod Project. This project has as its premise a three-pronged approach for improving academic success which involves 1) mastery of academic content, 2) use of effective pedagogy, and 3) building positive student-teacher relationships.

Project funds were used to support the District's professional development work with Dr. Ronald Ferguson of Harvard University, faculty outreach efforts targeted primarily at African American students, parent involvement activities, evening meetings featuring adult role models, and developing student groups at the upper elementary and middle school levels patterned after the MAC (Minority Achievement Committee) program at the High School. Based on the successes of this initiative and growing local, state and national concern about improving student achievement in elementary and secondary schools, the Gund and the Cleveland Foundations awarded the District an additional \$360,000 over the 2002-03 and 2003-04 academic years. These funds will enable the District to continue the activities underway and augment them by providing extended learning

experiences to underachieving students, expanding technology to help boost mathematics and reading skills, and improving study skills. Successful implementation of this project will enable the District to continue its leadership role in sharing research and best practices for improving student achievement throughout Greater Cleveland, statewide and nationally. More specifically, the District will disseminate information about the Tripod Project on its website, at first-ring suburb meetings, educational workshop/conferences and the national Minority Student Achievement Network (MSAN) meetings. (MSAN is a national network consisting of 14 high-achieving school districts dedicated to improving minority student achievement).

VI. CONCLUSIONS & RECOMMENDATIONS

The Committee's conclusions were based upon the premise that the Board would choose to maintain the current high level of educational programming.

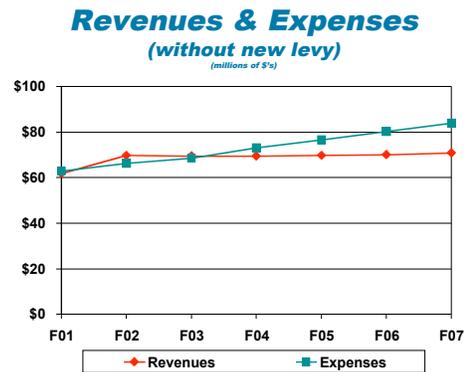
1. The Committee concluded that the forecast assumptions used by the Treasurer are reasonable.

These assumptions necessarily involve some less than certain predictions about future revenue and cost increases. Noteworthy areas of uncertainty include:

- o the final outcome of the State school funding lawsuit, known as *DeRolph*;
- o the reduction in property tax revenues due to the deregulation of the electricity and natural gas industries;
- o the phase-out of the inventory portion of the commercial personal property tax;
- o the level of financial support from the State, given the current state budget crisis;
- o the rapid growth in health insurance costs;
- o the unpredictability of utilization and, hence the market cost of energy, especially natural gas;

- o the increasing incidence and cost for special education services; and
- o the increasing volume of state and federal mandates.

Even with these uncertainties, the District's five-year compounded annual growth rate for its forecasted budget averages only 4.8%, which compares very favorably with the neighboring district statistics.



2. The Committee concluded that the financial projections are reasonable. Consequently, additional operating revenue is needed in order to avoid a financial deficit.

During the 2003-04 fiscal year, the District's operating expenses are expected to exceed recurring operating income by \$3.8 million or 5.5% of income. This large operating deficit is funded out of the accumulated surplus from the two fiscal years following the last operating levy in 2000. Without a levy, the fiscal 2003-04 deficit will reduce the carryover budget surplus to only \$4.8 million at June 30, 2004 (which amounts to less than 7% of expenditures). This accumulated surplus will be insufficient to fund the currently forecasted operating deficit of \$7.0 million for fiscal 2004-05. Therefore, without a new operating levy in 2003, expenses would need to be reduced by an estimated 5.3% in fiscal 2003-04 and 10.2% from those forecasted for the 2004-05 fiscal year. Cuts of this magnitude would severely damage the District's educational program.

3. *The Committee concluded that the District should continue to pursue the identification and implementation of cost-saving measures so as to provide the most efficient and effective services possible, both educationally and operationally, without sacrificing educational integrity.*

The Committee identified two areas to be worthy of particular study and action: the growing incidence and cost of special education programs in the District, and the rapid increase in the cost of health insurance benefits.

4. *Because of the delay between the successful passage of a levy and the collection of new tax revenues, the Committee concluded that the District should place an operating levy on the ballot in 2003 so as to sustain the high quality of educational service currently being provided.*

Given the magnitude of the projected operating deficits, any delays in the request or passage of an additional operating levy in the range of 9.5 to 10 mills would require significant reductions in current educational programs within the District.

APPENDIX

A1. ABOUT THE MEMBERS OF THE FINANCE & AUDIT COMMITTEE

Following are brief biographical sketches of the members of the Committee:

Marilyn Eisele is the chief financial officer of Five Star Technologies, a company that creates and produces advanced materials. Ms. Eisele received a bachelor's degree in business administration from Bowling Green State University and worked for 15 years for Coopers & Lybrand, now known as PricewaterhouseCoopers. During the past eight years, she has served as chief financial officer for both private and public companies. A Shaker resident since 1994, she is the mother of three Shaker students.

Kirby Freeman is in business banking with Huntington Bank. A graduate of Howard University with a bachelor's degree in print journalism, he holds an MBA in finance from New York University. He worked as a reporter for Reuters News Agency before moving into the business world. Mr. Freeman worked for four years at Standard & Poor's, where he gained experience in rating school districts and had an opportunity to become familiar with school finance in Ohio. Mr. Freeman represents Huntington on the loan review committee of the Cleveland Citywide Development Corporation. He has one child at Mercer Elementary School and two preschoolers.

Edward Hemmelgarn is the chief investment officer of Shaker Investments, a portfolio management firm based in Shaker Heights. He holds a bachelor's degree in chemistry and an MBA from Case Western Reserve University and worked at both Ernst & Young and Ameritrust prior to founding Shaker Investments in 1991. The father of a Shaker graduate and a current High School student, he is a trustee of the Shaker Schools Foundation and served previously as chair of the Citizens' Finance Review Committee.

Anthony Lockhart recently retired from First Energy Corporation, where he worked as sales director. He holds a degree in industrial technology from Miami University, as well as a master's in industrial economics from Case Western Reserve University and a law degree from Cleveland State University. A former member of both the Citizens' Finance Review Committee and the Shaker Heights Board of Education, Mr. Lockhart is a trustee of the Shaker Schools Foundation and Summa Hospital and past board chair of the Cuyahoga Plan, a fair housing organization. He is the father of two Shaker graduates.

James Rebitzer, Committee Chair, is Carlton Professor of Economics and chair of the economics department at the Weatherhead School of Management, Case Western Reserve University, with expertise in organizational economics, the economics of the labor markets, and the economics of negotiation and conflict resolution. Prior to coming to Cleveland, he served as a faculty member at MIT's Sloan School of Management and at the University of Texas-Austin. Dr. Rebitzer holds a bachelor's degree from the University of Illinois at Urbana, and a doctorate from the University of Massachusetts at Amherst. He is the father of two Shaker students.

Karen Schuele is an associate professor in the department of accountancy in the Bolar School of Business at John Carroll University. She holds a bachelor's degree from Case Western Reserve University, a master's from the University of Texas-Austin, and a doctorate from Kent State University. Prior to joining the John Carroll faculty, she worked for two years at Price Waterhouse, now PricewaterhouseCoopers. Dr. Schuele is on the executive board of the Ohio Society of Certified Public Accountants. A Shaker resident since 1984, she is the mother of three Shaker students.

Steve Strnisha is deputy director of Cleveland Tomorrow, a group of corporate leaders who are committed to improving the long-term economic vitality of the region. A former finance director for the City of Cleveland, he earned a bachelor's degree in history from the University of Virginia and a master's in public administration from Syracuse University. Mr. Strnisha worked at Society Bank and as an analyst for Moody's, where he covered public entities. He is a citizen member of the City of Shaker Heights Finance Committee and an outgoing member of the City of Cleveland's audit committee. He is the father of two current Shaker students and a preschooler.

Two Board of Education members are also serving on the Committee:

F. Drexel Feeling, a member of the Shaker Heights Board of Education, is an attorney with the Cleveland firm of Jones Day practicing in the area of intellectual property. Trained as an electrical engineer, he spent eight years in engineering and management positions in the U.S. Air Force. Mr. Feeling holds a bachelor's degree from the University of Pennsylvania, a master's in electrical engineering from Wright State University, and a law degree from The Ohio State University. He is the father of three children in the Shaker schools and has volunteered with the Ohio Reads Program.

Steven S. Kaufman, Vice President of the Board of Education, is a partner in the Cleveland firm of Thompson Hine with a specialty in business litigation. He was founding shareholder of Kaufman & Cumberland, a Cleveland firm that merged with Thompson Hine in 2002. President-elect of the Cleveland Bar Association, Mr. Kaufman is a graduate of Colgate University and the Case Western Reserve University College of Law. He served as special counsel to the Ohio Attorney General from 1991-98 and is a graduate of Leadership Cleveland. Mr. Kaufman has two daughters who graduated in the Shaker classes of 1997 and 2002.

A2. COMMITTEE REFERENCE MATERIAL LISTING

- 1. Finance & Audit Committee Charter & Insurance**
- 2. Shaker Heights City School District Fact Book**
- 3. Comprehensive Annual Financial Report (CAFR)**
- 4. Financial Statements-Monthly**
- 5. Five-Year Forecast**
- 6. Annual Information Filing (General Obligation Bonds)**
- 7. Annual Audit Reports**
- 8. "Spending Caps" Information**
- 9. Annual Appropriation Report (Budget)**
- 10. Citizens' Finance Review Committee Reports**
- 11. Levy History-Operating & Capital**
- 12. School Review - including "Annual Report"**
- 13. School Review - other issues**
- 14. Special Education Funding Issues Report**
- 15. Ohio School Finance Handbook – Stable**
- 16. Ohio School Foundation Funding Program**
- 17. ODE SF-3 Report for Shaker Heights City School District**
- 18. Ohio School Funding Case – *DeRolph***
- 19. "On The Money" - School Finance Information**
- 20. Ohio Department of Taxation - Business Tax Incentives**
- 21. Ohio Department of Taxation-Property Taxation & School Funding**
- 22. Ohio Department of Taxation-Inventory Personal Property Tax Information**
- 23. Ohio Department of Taxation-Public Utility Deregulation Information**
- 24. Website Reference List**

A3. NEIGHBORING DISTRICT COMPARISON TABLES

