Bond Accountability
Commission 2, Inc.

Issue 14

Half-mill levy revenue and spending

March 16, 2010

Introduction

Much attention has been given to expenditures of money from $335 million in bond and note sales authorized by Cleveland Metropolitan School District voters in 2001 as part of Issue 14. However, Issue 14 also included an additional continuing 0.5-mill permanent improvements levy. This report reviews the expenditure of money generated by the levy.

As part of Issue 14, the half-mill property tax levy and the expenditures of funds raised by the levy fall under the purview of the Bond Accountability Commission as its mission is defined in Board of Education resolutions and a Memorandum of Understanding between the School District and the BAC.

The importance of this mission is underscored by a finding for recovery recently issued by the Ohio State Auditor in the amount of $49,500 for the District's Maintenance Fund, which is funded by the half-mill levy. The findings stem from a charge for two copying machines that were paid for but never delivered. The District's former Chief Operating Officer has been indicted on criminal charges in connection with this expense. In addition, companies mentioned in connection with other criminal investigations have received money from the half-mill levy.

The District Finance Department reports each month the expenditure totals by school or other project for proceeds of Issue 14 bond and note sales. Expenditures of proceeds from the half-mill levy are not similarly reported. This Bond Accountability Commission report is preliminary in that it seeks only to outline the income and expenses of the Maintenance Fund, not to ascertain the legitimacy of individual expenditures.

Overview

Issue 14 on the May 2, 2001 ballot asked whether the Cleveland Municipal School District should be authorized to issue the $335 million bonds for a construction and renovation program but also included a second part, asking whether the District should be authorized to:

> Levy an additional property tax for general on-going permanent improvements at a rate not exceeding .5 mills for each one dollar of tax valuation, which amounts to 5 cents for each one hundred dollars of tax valuation, for a continuing period of time, commencing in 2001, first due in calendar year 2002?

Neither the Board or Education's authorizing resolutions nor the ballot language limited use of the tax proceeds to the construction and renovation program co-funded by the Ohio School Facilities Commission (OSFC). However, after Issue 14 was approved at the polls, the District entered the OSFC program. Among the OSFC's requirements was that a participating district dedicate or earmark proceeds of a half-mill levy to a separate Maintenance Fund established for maintaining all replaced or renovated facilities for 23 years. The Issue 14 half-mill levy was used for this purpose.

The OSFC also required that the District develop a preventive maintenance and capital planning program, including a complete maintenance budget, for its newly completed facilities – known as the Maintenance Business Plan. The required Maintenance Fund may only be spent on new or renovated facilities as recommended in the Plan.

More than $20 million in receipts. The District has received revenue from the half-mill tax since the second half of Fiscal Year 2002. Through Fiscal 2009, the District received $20.159 million in revenue from the half-mill tax. Full-year receipts have ranged from $2.922 million in Fiscal 2003 to $2.589 million in Fiscal 2009, declining each year.

However, the District was not required to deposit any money into the Maintenance Fund until Fiscal 2005. In addition, the OSFC did not require that *all* of the half-mill proceeds since then be deposited into the required Maintenance Fund. The annual amount required -- $2.465 million -- was based on the property-tax collection rate for 2004. Actual collections have exceeded that amount because the official rate is based upon on-time tax payments and does not account for collections of overdue taxes.

The result is that through Fiscal 2009 the half-mill levy generated about $8.567 million, including interest, more than the District was required by the OSFC to deposit into the Maintenance Fund. As of January 18, 2010, the District reported that $8.548 million of the surplus had been spent or encumbered, most if not all of it for expenses not eligible for spending under the Maintenance Business Plan.

The District has reported making the required $2.465 million deposit into the restricted Maintenance Fund on Dec. 31 of the last seven years. The State of Ohio also supplements that Fund.

Subsidy from state. Effective July 1, 2006, the Ohio General Assembly established a mechanism by which the Ohio Department of Education, subject to appropriation by the Legislature, annually subsidizes the Maintenance Fund of school districts such as Cleveland's that have per pupil property tax valuations that are lower than the statewide average.

The so-called equalization payment multiplies the difference between the statewide average property valuation per pupil and the District's per pupil valuation as of September 1, 2006, by one-half mill times the District's official enrollment in October 2005 (about 17,000 more than the current enrollment). The amount computed, in this case about $1.93 million, by law "shall not change for the period during which payments are made to the district," which is very beneficial for a district, such as Cleveland, which has experienced steeply declining enrollment.

Expenditure of this money is also restricted to the terms of the Maintenance Business Plan for new or renovated schools.

The total of required District deposits and the equalization payments so far is about $22.511 million. As of Jan. 18 2010, the District reported that spending and encumbrances of this restricted money totaled $627,960.73.

Judging by the Maintenance Business Plan compiled by a District consultant, the required District deposits and the equalization payments provide an amount that is by far insufficient to meet the actual maintenance needs of the District's new and renovated buildings. Recognizing that, the Plan offers a spending plan based on available funds, but there is no requirement that the District follow it.

Fund 034

All proceeds of the Issue 14 continuing half-mill levy are deposited into what is known as Fund 034 in the District's accounting system, according to the District's Finance Department. Within Fund 034, the District uses Special Cost Centers (SCCs) to segregate the amounts deposits required by the OSFC from the surplus revenue.

In an Oct. 7, 2009, letter notifying the District of an upcoming audit of Segment 2 of the District's 10-segment school construction program, the OSFC's deputy chief of finance said: "It is important to remember that projects related to Urban Districts are completed in segments that could span a twenty year period. As a result, it is likely that a District will be spending funds out of Fund 034, using separate cost centers for each segment."

The District attaches the code 034.1297 to the SCC for revenue and expenditures outside the Maintenance Business Plan. It has created other SCCs for the required deposits and equalization subsidies, one for each year.

Basing the required annual deposit -- $2.465 million -- on the on-time collection rate for 2004 has worked in the Cleveland District's favor for five years, giving it a surplus that it can spend from 034.1297 outside the OSFC's restrictions. However, as noted, the total collected each year from both on-time and past-due tax payments has been declining, raising the possibility that at some point the amount received by the District will fall below the required deposit, in which case the District would have to make up the shortfall from other fund sources.

At this time, the District is estimating half-mill revenue for the current Fiscal 2010 at the required minimum -- $2.465 million.

Half-mill levy expenditures

As might be expected with new or fully renovated schools, the expenditures and encumbrances for preventive maintenance and repairs from the OSFC-required Maintenance Fund have been relatively small so far.. The restricted Maintenance Fund had a reported available balance of $21.903 million as of Jan. 18, 2010.

An audit of agreed-upon procedures for Segment 1 schools from the beginning of the construction program through June 30, 2006, commissioned by the OSFC and performed by Julian & Grube Inc., found only nine expenditures from Fund 034, according to the accountant's report, which is dated February 17, 2009. Of those nine expenditures, seven were found to be in accordance with the interim Maintenance Business Plan. The other two, totaling $20,700, were deemed to be outside the scope of the Plan. The audit report says the District removed those expenditures from Fund 034 on March 7, 2007.

(The District was notified of a Segment 2 audit in October 2009.)

The Segment 1 audit report does not say whether examiners reviewed expenditures from the 034.1297 SCC for half-mill tax revenue in excess of the required amounts. However, they apparently did not review 034.1297, as there were approximately 75 expenditures from that SCC during the audit period.

$8.6 million of surplus spent. Expenditures and encumbrances of the surplus beyond the OSFC-required set-asides have totaled $8.548 million as of January 18, 2010, according to the District.

A spreadsheet summary of expenditures from SCC 034.1297, supplied by the District and dated Feb. 5, 2010, shows about 3,200 debits to the account. Descriptions of the purpose of the work itemized on the spreadsheet are truncated and in some cases absent, but in general they appear to be for capital items such as fencing and security equipment, but also for repairs of plumbing, heating/ventilating/air-conditioning systems, roofs, lighting, and the like; routine tasks such as painting, plastering, battery replacements, repair of pavement chuckholes and inspections of boilers and fire-safety systems; and purchase of custodial equipment. Also included is work to upgrade various administrative facilities, including the downtown headquarters of the District.

Where a location for the expense is listed, most of the schools are those that are no longer part of the Master Plan for replacement or renovation or are part of Master Plan segments yet to be executed.

Documentation helpful. Some 300 expenses are simply listed as for "payroll" without indication of what work was done, who did it, or where it was done. In addition, a significant number of checks were written as "compensation" to various building trades unions without indication of what work was done or where it was done. No purchase orders are listed for either the payroll or union payments. The Finance Department has indicated that the "payroll" expenses were for work done by the District's own building trades employees. The union payments stem from the District employing temporary trades workers.

No payroll or union charges to 034.1297 appear on the District-supplied spreadsheet after the last quarter of 2007. However, two charges totaling nearly $39,000 – on March 31 and December 31 – occurred in 2008 for "SERS Surcharge." SERS is an acronym for the School Employees Retirement System of Ohio. No purchase order number or information about what work was performed is provided.

Nor is a purchase order number, check number, recipient or location provided for a $111,742.79 charge for "start up cust equip" on April 24, 2008.

Complete information on spending reports, including purchase order, invoice and check numbers and the purpose and location of expenses, can help establish the legitimacy of expenditures, although such information is not definitive. For example, purchase, invoice and check numbers (though no District facility) are listed for the previously mentioned copiers for $49,500 cited by the State Auditor.

In any case, scrutiny of individual expenditures is beyond the scope of this preliminary report. Further inquiry may be merited to assess the propriety of some Fund 034 expenses, including those from SCC 034.1297.

Permissible uses. The Finance Department reported that it had received an opinion from outside legal counsel that the type of spending in 034.1297 was permissible under language of Issue 14, which for the half-mill levy would be "general ongoing permanent improvements."

The Ohio Revised Code generally defines a permanent improvement as any property, asset, or improvement having an estimated life or period of usefulness of five years or more.

The District's Comprehensive Annual Financial Report for fiscal year 2008 states in reference to Issue 14: "The voters of the City of Cleveland approved a new property tax levy in May 2001 (Issue 14), the first since 1996. This levy was approved to support the payment of the debt service for bonds issued for the school facility construction/renovation program and to support the ongoing maintenance of those facilities. Collections cannot be used to support the general operations of the School District."

Maintenance Business Plan

Examination of Fund 034 expenditures requires an understanding of the Maintenance Business Plan required for schools in the OSFC-funded construction and renovation program as well as of the District's general approach to maintenance of all its buildings.

According to an OSFC policy memorandum, the Maintenance Business Plan must include a "complete maintenance budget including initial, annual and long-term expenditures (year by year revenue and expense projection over 23 years)."

The plan is subject to approval by the OSFC, and a Board of Education resolution is also required. The memorandum states:

> The Board of Education will be required to acknowledge the following:
>
> 1) Allowable uses for the Maintenance Fund shall be the maintenance and repair of the facility, including preventative [sic] maintenance, periodic repairs, and the replacement of facility components as recommended in the approved plan;
>
> 2) Routine janitorial and utility costs, equipment supplies and personnel associated with the day-to-day housekeeping and site upkeep per normal and customary standards are not allowable expenditures under the parameters of the Maintenance Fund;
>
> 3) The actual use of the Maintenance Fund according to the terms of the approved Maintenance Plan is subject to audit;

4) A five (5) year Capital Plan should be updated on an annual basis, while the complete Maintenance Plan should be updated each five (5) years and approved by the Board.

The District operated initially under an interim maintenance plan. The Maintenance Business Plan, prepared by Resource International Inc., of Columbus, Ohio, was approved by the OSFC in February 2009.

Maintenance policy. According to the Finance Department, the District does not have a comprehensive maintenance budget that is based on an assessment of how much money is needed to keep all of its buildings and equipment in optimum operating condition.

The report by Resource presents a scenario that it says "most closely resembles the District's current operations" regarding maintenance. A district following that scenario "only performs maintenance tasks that are required by statutory regulations [such as for fire and other safety systems]. ... The balance of the building assets and equipment receive minimal maintenance and is in most cases ignored until an emergency repair arises. Since most of the unplanned maintenance is handled in an emergency basis, there is a cost penalty for paying overtime to perform the repairs. In addition, the unexpected repairs will likely disturb the building operations and inconvenience the occupants since some of it might have to be done during regular hours." Resource International added, however, that "the District goes beyond the minimal preventive maintenance described in this scenario by using the Building Trades Division team of licensed and skilled workers, as well as outside contractors.

The report says a type of work not done under this scenario is replacement of subcomponents of a larger piece of equipment to help that building unit or system reach its full life expectancy. "An example of this would be the scheduled removal and replacement of a fan motor or a compressor out of one of the chiller units," Resource International said.

The District had the full-time equivalent of 69 maintenance employees in Fiscal Year 2008 (ended June 30, 2008), a 33 percent decline from the number in 1999.

Protecting capital investment. The Maintenance Business Plan deals only with the District's new and renovated school buildings.

"The plan concentrates on the budgetary issues, as well as provides guidance with regards to stewardship of these educational facilities based on industry best practices," Resource International said. "... This document provides suggestions and strategies to help the District bridge the gap between the most desirable parameters for the ideal maintenance of the facilities and the current resources available to the district."

Referring to the hundreds of millions of dollars involved in the District's construction and renovation program, Resource International said: "The goal of the maintenance plan is to protect this capital investment. A program of preventive and restorative maintenance helps preserve the integrity of the buildings in order to provide the most suitable educational environments over a longer period of time."

The Plan was established for five schools in Segment 1: Rickoff, Memorial and Riverside elementary schools and John Adams and John Hay high schools but is the template for maintenance of all schools in the construction and replacement program.

“The negative repercussions of under-funding maintenance are significant,” the Plan says. “The equipment’s performance and efficiencies will be undermined and lack of preventive maintenance will shorten the life expectancy of the equipment while increasing its operational cost. Lack of preventive maintenance also increases the likelihood of major breakdowns that could disrupt the scheduled operations of the school facilities, jeopardizing their intended function. Furthermore, inadequate or improper maintenance could invalidate the manufacturer’s warranty, which could result in a major financial drain to the district if a major piece of equipment is not covered by the warranty and needs to be repaired or replaced in an emergency situation. Finally, the lack of proper maintenance of life/safety systems has major moral and financial implications to the district if such equipment/systems were to fail in an emergency situation and someone were to get hurt.”

Budget for available funding. That said, the report acknowledges that available resources – the sum of the District’s pre-existing maintenance budget for the five schools, plus the pro-rated half-mill levy proceeds and the state equalization moneys – are much less than the amounts that the consultants calculated are needed for optimum maintenance. It therefore recommends an available-funds budget for the five schools, based on their square-footage proportion of the overall construction and renovation program and their enrollment.

The budget covers five areas: the wages of in-house skilled trades workers and maintenance workers, materials and equipment, costs for outside contractors, training of in-house staff in servicing the new equipment and systems, and capital renewal (periodic replacement of major components or infrastructure systems at or near the end of their useful life as well as repair work such as tuck-pointing brickwork).

The consultants calculated the ideal annual maintenance budget for the five schools at $1.981 million. For the available-funds budget, they combined what they said was the existing maintenance budget of $0.325 million with the pro-rated half-mill and equalization funds, yielding $0.241 million, leaving an annual shortage of $1.415 million, or 71.4 percent, below the ideal. These figures include $5,000 for training of District staff to service new equipment, which presumably would not have to be repeated every year.

The five schools in the initial Maintenance Business Plan were completed in Fiscal 2006 and 2007. If the District had spent the recommended available funds amount of Fund 034 on maintenance of those schools in Fiscal 2008 and 2009, the total would have been about $482,000. However, the District reports spending a total of only $278,000 through Fiscal 2009 from the restricted portion of the Maintenance Fund, even though it also had additional Segment 2 schools to maintain.

Conclusion

The half-mill levy approved by District voters as part of Issue 14 in May 2001 has thus far provided more annual revenue than the required deposits in Fund 034 for maintenance of schools replaced or renovated in the program co-funded by the OSFC. The District has spent that surplus, largely on maintenance of other schools.

However, the required deposits, even combined with state equalization payments based on substantially more students than the District currently has, are far less than a consultant says the District needs to efficiently maintain its new or renovated schools.

A trend of declining collections of the half-mill tax suggests that in future years, the District may be forced to tap other sources of funds to make the required deposits in the Maintenance Fund.

The District unquestionably has substantial maintenance needs at many schools that are not part of the OSFC program, yet the desirability of maximizing the life and performance of the new schools and the prospect of the half-mill levy some day not yielding sufficient revenue suggest that the District should consider limiting future expenditures of Fund 034 to new or renovated schools. To do otherwise will run the risks that the new schools will suffer the same deterioration that has plagued the buildings they are replacing and/or that scarce operational funds will have to be spent on meeting the OSFC requirements for the Maintenance Fund.

In any case, transparency and accountability demand that care be taken fully to document all expenditures from Fund 034.

Questions or comments?
Contact the BAC at bondaccountability@hotmail.com