

KNOX COUNTY SCHOOLS

ANDREW JOHNSON BUILDING

Dr. James P. McIntyre Jr., Superintendent



MEMORANDUM

To: Chair and Members
Knox County Board of Education

From: Dr. James P. McIntyre, Jr. 
Superintendent

Date: March 11, 2015

Subject: FY16 Preliminary Budget Recommendation

This memorandum and the documents that follow represent the preliminary budget proposal for the Knox County Schools Fiscal Year 2016 (FY16) General Fund Budget. As you will see in this package, I have presented the Board of Education with a preliminary budget recommendation of \$440.7 million, which represents an increase of \$15.9 million (3.7%) over the current FY2015 Budget.

General Fund Budget Structural Challenges

The level of revenue growth assumed in this preliminary budget would, in most years, be adequate to sustain our educational efforts. However, there are a number of structural dynamics at play in the development of this year's budget that have compounded the annual challenge of presenting the School Board with a fiscally responsible budget that meets the educational needs of our students. These dynamics include:

Revenue Growth vs. Necessary Expenditures

Revenue growth is any increase in funding the school system receives from the levels approved in the previous year's budget. The Knox County Schools traditionally experiences some revenue growth that is generated largely from growth in state Basic Education Program (BEP) funding, local options sales taxes and property taxes. The level of revenue growth we have experienced for a number of years has been in the range of one to three percent. However, the corresponding growth of our fixed increases (debt service, utilities, retirement contributions, Trustee's commission, etc.) and budgetary obligations has been more in the range of four to five percent year over year. This creates an annual revenue shortfall that we have to address either through difficult reductions in spending, fund balance appropriations, and/or other strategies.

Fund Balance Levels

Our fund balance represents the accrual of any funds that are unspent from an annual budget, as well as any revenues that are collected in excess of what was appropriated by the County Commission. School systems in the State of Tennessee are required to maintain a fund balance level equal to at least three percent of our operating budget. Any funds that accrue in excess of the three percent level may be used by the School Board to address non-recurring expenses in a given year.

We have used our fund balance judiciously in recent years to bridge the gap between our limited revenues and our necessary expenditures. However, the demands made on our fund balance over time have moved us very close to the required three percent level, and this is no longer a viable strategy to help balance our significant educational needs with our limited revenue. This dynamic greatly limits our budgetary flexibility and reduces the strategies available to us to meet our educational needs.

Modification to Accounting Practice

One strategy we have used on a limited basis in recent years to help balance our budget has been to pay for certain known expenses for the coming fiscal year with unspent funds from the current fiscal year. With the consent of the County Finance Office, we have used this strategy to address costs related to closed retirement plans and increases to our capital debt payments over the past few years.

This year, our auditors have indicated that they would prefer that we account for these expenditures in the year in which they are incurred rather than pre-paying them. Therefore, these costs of several million dollars will now represent actual expenses in FY15 that will have to also be accounted for in the FY16 budget development process, adding to our budgetary challenges.

All of these dynamics represent a structural challenge that we will be unable to overcome, absent a significant increase in revenue, without making some very difficult budgetary decisions. If these dynamics continue, we will face these difficult choices in each budget cycle for the foreseeable future. To date, we have largely been able to protect school-based expenditures, in part by utilizing the strategies discussed above, but our ability to continue to do so is rapidly diminishing.

Adjusting Budget to Reflect True Costs

There are several examples of real expenditures in the current fiscal year that are anticipated to exceed the budgetary resources allocated for that line item. Many of these expenditures, such as volunteer background checks, photocopier use at the school level, and athletics insurance, represent instances where the school system has made a decision to undertake the activity, but where the cost has turned out to be greater than anticipated.

Other costs over the current budget include situations where specific policy decisions were made during FY15 that would incur additional cost, such as the substitute teacher enhancement strategies and fee waivers. In both of these situations, this budget attempts to recognize these real costs and define a strategy for accounting for them, whether absorbing them within the general fund appropriation, funding them with traditional savings in the salaries budget line, or simply funding them in the FY16 budget. In a variety of ways, the FY16 budget proposal includes a concerted effort to acknowledge and address these necessary expenditures.

Priorities: Teacher Compensation

This year the Governor has asked the General Assembly to approve a budget that includes a four percent increase to the state compensation pool of funds for teachers. While these funds are available for districts to apply to teacher compensation in any number of ways, I propose that we use this revenue to increase the level of base pay for our teachers. This is in keeping with the priority that we established in our strategic plan and reinforced in our recent memorandum of agreement with the Knox County Education Association.

Therefore, this budget proposal includes a four percent raise for all certified teachers.

On its face, this might appear to be a revenue neutral action based on the Governor's recommended budget, but it is not. The teacher compensation funding will be distributed through Basic Education Program (BEP) formula, which only accounts for certain teaching positions, and contains a "fiscal capacity" calculation. These two provisions mean that the Knox County Schools will only receive from the state about 40% of the funding necessary to provide a 4% salary increase to all of our certified teachers. In other words, of the \$10 million cost to give all KCS certified teachers a 4% raise, the state is only funding about \$4.4 million.

This budget proposal would apply every cent we receive from the state for teacher raises to that purpose. However, of the total \$10 million cost, we will still need an additional \$5.6 million in order to give a full 4% raise to teachers. We will ask the County Commission to fully fund and appropriate this difference, over and above expected revenues, so that we can provide a 4% salary increase for our certified educators.

Our teachers continue to do an extraordinary job of facilitating student learning and success in an era of great change and enhanced expectations. In order to retain our outstanding teachers and recruit the next generation of exemplary educators, we must ensure that we offer a more competitive and professional level of compensation for our teachers.

Priorities: Sustaining Educational Success

As in FY15, our fiscal constraints continue to preclude significant additional educational initiatives in the FY16 budget, and they require us to look closely at our educational programs to ensure we are investing our limited resources where our educational strategies are yielding success.

This budget recommendation will allow us to continue to focus on implementation of the many educational enhancements and initiatives that we have put in place over the past several years. This proposed budget will allow us to continue and sustain our important efforts in the classroom, including:

- rigorous academic standards
- continuous instructional improvement
- early literacy
- personalized learning supported by instructional technology
- professional growth through a developmental evaluation
- teacher leadership
- educator collaboration, and
- high quality professional development and support.

Although we have not been definitively notified, this budget assumes that the funding for our early literacy efforts will continue to be forthcoming for FY16. Mayor Burchett and the County Commission have been good enough to invest \$2.87 million annually for the past three years in the important foundations of reading in our elementary schools, and the report we sent to the Mayor in January shows some encouraging results in the early grades (K,1, and 2). If these funds are not appropriated for FY16, unfortunately, we would be forced to cut this critical program in its entirety. With limited budgetary flexibility, the loss of these funds would be devastating to our early literacy efforts.

Reductions: TAP, APEX, Positions, Summer Bridge, Project GRAD

While we have focused on preserving instructional programming and supports, this budget proposal is not without significant pain points both instructionally and operationally. For example, with the loss of most grant funding for the TAP System, we will have to drastically curtail the number of schools that participate in the program. While TAP has been a very successful instructional improvement program, the sunset of the \$25 million Teacher Incentive Fund (TIF) grant simply cannot be replaced by general fund dollars. Therefore, in all likelihood, we will move from 18 TAP schools to about four or five.

We will only be able to retain TAP in those schools where it is demonstrating the greatest impact and where the staff fully supports the initiative. Funding for the TAP System will be significantly reduced due to the end of the TIF grant, but over the past five years we have built considerable instructional and leadership capacity in those schools where it has been implemented with fidelity. Our challenge now is to ensure we fully capture these lessons learned and develop a process through which we will implement them at schools across the district.

This budget recommendation would also eliminate \$3.2 million in APEX performance incentive payouts in FY16. These financial incentives were slated to be paid in November, but would have been fully earned by the end of the current school year. We have committed to undertake a complete redesign of the APEX strategic compensation program

this spring that would take effect in the 2015-16 school year. Some have suggested that we perhaps continue paying the APEX bonuses while we redesign the program, but unfortunately there is neither strong support for the program as currently structured, nor the funds available to so. This reduction would be a conscious choice on the part of the School Board to eliminate the incentive payments more than halfway into the school year in which they are being earned, but despite the disadvantages, this is perhaps the most reasonable course of action. We would have to be disciplined about funding APEX incentives again in the FY17 budget to support the redesigned strategic compensation program.

While we have worked diligently to preserve school-level positions, this challenging budget proposal does include a very modest net reduction of five teaching positions and twelve school level clerical positions, which we believe can be absorbed largely through attrition. It also proposes the reduction of four positions from central office and school-wide positions, a roughly 10% reduction to Project GRAD funding, a 50% reduction to our Summer Bridge Program, a significant reduction to extended contract funds (which are not funded in the Governor's budget), as well as out of county travel and use of timecard personnel.

As we continue our work to finalize this budget, I fully expect that we may have to make additional reductions in our maintenance and information technology budgets in order to fund increased fixed costs in those departments.

Future Considerations

Despite reasonable revenue growth, the FY16 proposal has been an exceedingly challenging budget to develop. It is rife with difficult dynamics and unattractive tradeoffs. Yet, there are many educational needs that are not addressed in this budget. Expansion of comprehensive instructional technology, and several other long-term priorities identified in our strategic plan are not yet funded in this budget proposal. In order to ensure we are providing a truly outstanding education to every student in our school system, we will need

to solve our structural financial issues, commit to a level of funding commensurate with our rigorous expectations, and appropriately invest in public education in our community.

Conclusion

In many ways, this is a challenging budget that has forced us to make some painful reductions as we have been unable to absorb into our operating budget some largely successful initiatives that had been supported by grant funding. However, we have worked diligently to ensure that this budget recommendation will allow us to continue the high quality teaching and learning happening in our schools, and sustain the strong academic progress we are making. We have been disciplined in designing a FY16 budget plan that is tightly aligned to our educational priorities.

In FY16, we will continue to improve our internal controls to ensure that every dollar we are appropriated is used wisely, appropriately and effectively to support the education of our children. This budget also highlights the significant structural challenges that we face from a fiscal perspective in the Knox County Schools.

This FY16 budget is not an ideal proposal by any means, but it is a budget that is reasonable, responsible, and supportive of the terrific educational work happening in our classrooms across our school system. Ultimately, I feel strongly that if fully funded, this is a budget that will move us forward in our journey toward our ambitious goal of *Excellence for Every Child*.

We will provide a more detailed budget document that includes departmental breakouts and individual line items by the end of the month. I look forward to discussing this preliminary budget proposal with you at the School Board meeting.