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Ms. Julie Doyle, Chairman
Lynchburg City School Board
915 Court Street
Lynchburg, VA 24504

Dear Chairman Doyle,

At your request, I have worked diligently to discover the contributing factors to the shortfall in revenue and the excesses in expenditures in the Lynchburg School System financial activities for fiscal year 2007-2008.

The following is a summary of that effort:

First, a look into how the 2007-08 budget was constructed, beginning with the sources of revenue upon which the 2007-2008 budget was built. In the three years preceding 2007-08, actual average daily membership (ADM) as reported on March 31, had been relatively unchanged. Indeed, during the spring of 2007, when the revenue projections for 2007-08 were being prepared, the latest student count, that of September 2006, showed an increase of eight (8) over the September 2005 count. In view of this, revenue for 2007-2008 was based upon the optimistic assumption that declining enrollment was a thing of the past. In fact, the ADM projection for 2007-08 was 8,610, twelve (12) students below the September enrollment for the 2006-07 school year, but 103 students over that year's March 31 ADM. Actual March 31, 2008 ADM, however, came in 309 below that budget estimate. Further, the 2007-08 budgeted sales tax revenue estimate was almost \$400 thousand dollars above the Virginia Department of Education projection. Actual final sales tax receipts for 2007-08 were \$400,097 below the budgeted amount. These two components coupled with smaller variances in other state funding sources, yielded a net shortfall in the basic revenue categories of over \$1 million dollars.

On the expense side, similar errors were encountered. Salary expenses for instruction and for operations and maintenance, each exceeded the budget estimates in excess of \$365 thousand dollars. Additionally, the revenue and expenditures for the LAUREL program, for which Lynchburg Schools is the fiscal agent, were omitted entirely from the budget. The cost of that program was \$663 thousand dollars, adding that amount to the pending expenditure deficit. Fortunately, revenue from the LAUREL program was \$693 thousand, more than offsetting the costs incurred. Significant balances in other expense categories, most notable capital outlay, helped defray some of the expense overruns.

In the final analysis, salary/wages and fringe benefits costs exceeded the budget by \$713 thousand, or about 1%. Taken as whole, and using the tools that are available, salary estimates would *not* normally be expected to yield a deficit. More typical is that budgeted salaries and benefits have a positive balance due to attrition; that is, if the budget had been adequately funded for all incumbent staff, vacancies and new hires would be expected to yield a positive fund balance.

The budget figures for all salaries, wages and benefits were/are provided to the finance office by the Human Resources department. It is known that a new salary schedule was implemented for fiscal year 2007-08, but no tests have been done in this review to assure that the applications of the new scales were followed correctly.

Compounding already difficult circumstances, was the assumption by the new CFO that no June report was generally provided to the Superintendent or the Board. The CFO had been informed that the audit report sufficed for a closing statement. Consequently, the last report provided to the Superintendent and the Board in the fiscal year 2007-08, was May 2008. Unfortunately, when the May 2008 financial report was prepared, teachers salaries for June, and deferred pay for July and August were still to be recorded. It was not until the auditors posted those accruals that the deficit was revealed. No internal financial reports were provided at the end of the fiscal year 2007-08.

The reporting that had been, and is still being done, however, falls considerably short of a financial report from which one could make sound, well informed financial decisions. While the report shows expenses and obligations as amounts side by side with budgeted amounts, they provide no analytical advice. Where expenses are on-going from year to year, the reports could be vastly improved by the addition of extra columns or additional sheets that compare the percentage of funds used this month, and year-to-date to the prior year percentage of funds spent for the comparable month and year-to-date. From these two additions, trends can be spotted, even by a fiscal novice. While this is not a solution to a budget that is deficient from the beginning, regularly prepared and reviewed projections can alert management to the need to do deeper study to assure that funds are made available for increased needs or that changes are made to expenditures sufficient to offset pending deficits. Such detail might also provide the CFO an opportunity to post many of the year-end adjustments that might be necessary before turning the books over the auditor.

Like expenditures, the monthly financial report should include a complete revenue report using the same management tools as the expense side of the budget. Considering the current state of the Virginia economy, it is particularly important to monitor state revenue. Unlike expenditures, revenue transfers cannot be made between categories to make up a shortfall. A pending shortfall in total revenue could signal the need to reduce expenditures to assure that expenses do not exceed appropriations or the estimate of annual revenue.

Clearly, some of the variances of fiscal 2007-08 could have been foreseen using proper monitoring techniques and recognizing that Lynchburg used accrual accounting. The CFO, however, now better understands the importance of control, monitoring and reporting. There is little doubt that there are new things still to be learned about the Lynchburg system, but learning is ongoing. An assessment of the current CFO qualifications is very positive. The education, the on-task skills and the will to carry out the requirements of the office at a very high level, are all evident.

Proof of such skills and attention will show up at the end of the third quarter when new up-to-date projections of revenue and expenses are presented and recommendations to prevent a repeat of the trials of FY2008 are brought forth.

Respectfully Submitted,

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