February 13, 2014

MEMORANDUM

TO: District School Superintendents

FROM: Joy Frank

RE: Legislative Update – Week of February 10, 2014

General Information

The Joint Legislative Auditing Committee requested that FADSS, FSBA and the Auditor General submit recommendations that would improve district school board oversight in light of the fiscal issues in Manatee County School District. I testified along with Dr. Wayne Blanton. In addition, Superintendent Mills and Julie Aranibar, the school board chair made brief comments. The Auditor General made a presentation on the current statutes relating to school district auditing and recommended potential oversight enhancement including:

> Require school districts above a specified size to employ an internal auditor to periodically report to the Board on the effectiveness of budgetary control procedures including staffing allocations and expenditure monitoring.
>
> Auditor General operational audits will include audit testing for all years subsequent to the previous operational audit for those audit findings in which questioned costs were reported.
>
> Request presentations before the Legislative Auditing Committee from all school districts with fiscal year ending assigned and unassigned fund balances in the general fund totaling less than 2 percent of general fund revenues.
>
> Require a specific monthly financial statement format to be determined by FDOE for use by School districts with fiscal year-end total general fund assigned and unassigned fund balance below a specified percent of general fund revenues
>
> We recommended in our recent Annual Report that the Legislature consider amending applicable Florida Statutes to establish in law the responsibility of each State and local government to maintain internal controls designed to:
>
> - Prevent and detect fraud, waste, and abuse;
> - Ensure the administration of assigned public duties and responsibilities in accordance with applicable laws, rules, contracts, and grant agreements;
> - Promote and encourage economic and efficient operations;
> - Ensure the reliability of financial records and reports; and
> - Safeguard assets.
>
> Stating this responsibility in law may encourage school districts and other governmental entities to take seriously the responsibility to establish adequate internal controls rather than only doing so in response to audit findings.

A letter to the committee summarizing my comments is attached.

Florida Retirement System

As you no doubt have read, the Senate Committee on Community Affairs has filed proposed legislation - SPB 7046 that would substantially modify FRS, especially for newly hired employees. It will be heard in the Senate Community Affairs Committee on February 18th.

The House has not released a proposal, but had a presentation before the House State Affairs Committee on the current retirement system.

FRS "At a Glance"

- Annual employer contributions - $1.6 billion
- Annual employee contributions - $830 million
- Active participants - 621,774
- Annuitants - 334,682
- Funding ratio as of July 1, 2013 – 85.9 percent
- Market value of assets as of July 1, 2013 - $131.7 billion

Two Plan Options

Investment Plan (defined contribution plan)
- Funded by employer and employee contributions
- Participants determine how the funds in their accounts are invested (among various state-offered options)
- Participants bear the risk of their investment decisions
- 107,338 (17%) active members

Pension Plan (defined benefit plan)
- Retirement benefit is formula-based payment funded by employer and employee contributions and investment earnings
- Employer bears investment risk
- Fund managed by State Board of Administration
- 514,436 (83%) active members

Required participants: state, school boards, county governments, universities, state colleges. Optional: municipalities and special districts.

Active Membership by Employer
- State – 102,143 or 16.4%
- Universities – 24,247 or 3.9%
- **School Boards – 305,317 or 49.1%**
- State Colleges – 20,458 or 3.3%
- County Government – 139,788 or 22.5%
- Cities and Special Districts – 29,821 or 4.8%

Class Structure

- Regular Class – Members who do not qualify for membership in other classes within FRS.
- Special Risk Class – Law enforcement officers, firefighters, correctional officers, correctional probation officers, paramedics, EMTs, certain professional health care working within DOC and DCF and certain forensic employees.
- Special Risk Administrative Support Class – Former special risk members transferred or reassigned to administrative support position.
- Elected Officers' Class – Members who hold specified elective offices.
- Senior Management Service Class – Senior management level positions assigned or authorized by law.

The pension plan benefit calculation is – years of service X accrual rate X average final compensation. Example: 30 years of service X 1.6% accrual rate X $40,000 average final compensation = $19,200 annual benefit. Accrual rates differ among classes of employees.

An actuarial valuation is performed annually on the FRS to determine funding status and employer contribution rates. Employer contribution rates are set annualyl in law. The Legislature generally adheres to recommended rates and funds accordingly in the General Appropriations Act for education entities and state funded entities. As of July 1, 2013, the pension plan had an actuarial funding level of 85.9 percent. The unfunded actuarial liability (UAL) is $21.6 billion. The UAL must be amortized within 30 plan years, as required by law. For 2013-14, $500 million in recurring GR funds was appropriated towards payment of the UAL (State, Universities, State Colleges and School Boards).

Various types of plans were provided for discussion.

Basic Plan Types

- Traditional pension plan (defined benefit or DB plan)
    - FRS Pension Plan is one of these
    - Fixed benefits for employees, with no investment risk exposure
    - Variable cost for employer, with all the investment risk exposure
    - Benefits more generous for long career employees ("back-loaded")
- Defined contribution plan (DC plan)
    - FRS Investment Plan is one of these
    - Fixed contributions for employer, with no investment risk exposure
    - Variable benefits for employees, with all the investment risk exposure
    - Benefits are evenly earned throughout career ("generally more portable")
- Risk-sharing plans
    - Combination DB + DC plan
    - Cash balance plan
    - Other more exotic flavors (e.g. target benefit, shared-risk DC, collective DC)

Risk-Sharing Plans: Combined DB + DC Plan

- Employees earn benefits in both a DB plan, and in a DC plan. For example:
    - Employee contributions flow into a DC plan.
    - Employer provides a DB plan with modest benefits.

- Total benefit is the sum from both plans.
- Simple to implement and understand.
- Has long history -- typical large company arrangement through mid 90's.
- Shared risk exposure between employee and employer.
- Currently used by 10 states.

Risk-Sharing Plans: Cash Balance Plan

- Looks like DC plan to employees, but…
- Accounts are "notional" accounts with no investment options (employer responsible for investing).
- Interest credits are defined, and partially guaranteed by employer (leaving employer with some risk and possible unfunded actuarial liability).
- Definition of the interest credit provision is the primary design issue:
    - Could be a fixed rate (e.g. 5% per year)
    - Could link to an outside rate (e.g. Treasury bill + 1%)
    - Could be based on fund returns (e.g. 4% plus 50% of returns over 4%)
- At retirement the account is usually paid as lump sum, but can also be annuity.
- Currently used by 5 states.

Investment Risk = Uncertain Results

- About 70% of benefit payments are funded from investment returns, and 30% from employee/employer contributions.
- With a mix of 70% equities and 30% bonds, the expected return over time might be 7.25% per year.
- But actual return experience is very uncertain over a 33 year period (i.e. length of employee career)
    - Could be as low as 3.5% (10th percentile)
    - Could be as high as 10.5% (90th percentile)
- This level of risk is difficult to handle for either employers (in DB plan) or employees (in DC plan).

Comparing the Options

- Assume the same level of expected cost for each type of plan:
    - Employee contributions at 3% of pay
    - Employer contributions at 3.5% of pay (for Regular Class employee)
- Key issues for comparison:
    - What are the expected benefit levels?
        - For a full career employee?
        - For a mid-career termination?
    - How much uncertainty is there in the benefit level (i.e. how much can they deviate from the expected amount)?
    - How much uncertainty is there in the employer cost?
        - If employer is providing either full or partial guarantees for some benefits, then unfunded liabilities will be generated if results are worse than assumed.
        - These unfunded liabilities will affect the required employer contribution rates on a prospective basis.

Current DB Plan (FRS Pension Plan)

- Full career employees have very good benefits. For a Regular Class employee retiring at age 65 with 33 years of service, the benefit will be 53% of average pay.
- Mid-career terminations have relatively small benefits. An employee terminating with 15 years of service might receive a benefit (deferred to age 65) that is about 25% of what they would get if they kept working for 33 years.
- There is no uncertainty in the employee benefits (fully guaranteed).
- There is significant uncertainty in the employer cost due to investment risk that can create unfunded liabilities (or surplus assets).
    - Historical total cost rates have been as low as 5.8% and as high as 18.2%. Adjusting for a 3% employee contribution, the range of employer cost would have been from 2.8% to 15.2% of payroll.
    - The theoretical employer cost to fund benefits for a full career employee might be:
        - Expected cost = 3.5% of payroll
        - Low cost, with very good investment performance = 0% of payroll
        - High cost, with very poor investment performance= 12% of payroll

Current DC Plan (FRS Investment Plan)

- Full career employees receive benefits equal to about 50% of those for the Pension Plan. The reasons for this are:
    - Investment returns are lower,
    - More of the employer dollars go towards mid-career terminations, and
    - The cost of buying a lifetime annuity is significantly higher.
- Mid-career terminations have much larger benefits than under the DB plan – in the range of 50% to 70% higher.
- There is significant uncertainty in the employee benefits.
    - Depending on investment performance, they could be 50% higher, or 30% lower.
    - At the low end, employee replacement rates might fall below minimum desired levels.
- There is no uncertainty in the employer cost.

Combination DB + DC Plan (3% Employee Contributions to DC Plan)

- Full career employees receive benefits equal to about 80-85% of those for the Pension Plan. This reflects a blending of the pure DB results and the pure DC results.
- Mid-career terminations have benefits that fall between the pure DB plan and the pure DC plan. They might be about 40% higher than for the DB plan.
- There is some uncertainty in the employee benefits, due to the DC portion of the benefit.
    - Depending on investment performance, they could be 15% higher, or 6% lower.
    - At the low end, employee replacement rates are much less likely to fall below minimum desired levels.
- There is uncertainty in the employer cost, due to the DB portion of the benefit.
    - Depending on investment performance, they could be as low as 1.5% of pay, or as high as 9% of pay.
    - This level of uncertainty is about a 35% reduction in the risk for a pure DB plan.

Cash Balance Plan

- Full career employees will receive benefits roughly equal to those under the pure DC plan. These will be about 50% lower than for a pure DB plan, and about 40% lower than those under a Combination DB+DC plan. As with the pure DC plan, this is because:
    - More of the employer dollars go towards mid-career terminations, and
    - The cost of buying a lifetime annuity is significantly higher.
- Comparable to the pure DC plan, mid-career terminations have much larger benefits than under the DB plan, and larger than under the combination DB+DC plan.
- There is uncertainty in the employee benefits.
    - ***The results are very sensitive to how the interest credit provision is defined.***
    - At the low end, employee replacement rates might fall below desired levels, but the downside risk to employees is much less than in a pure DC plan.
- There is uncertainty in the employer cost.
    - ***The results are very sensitive to how the interest credit provision is defined.***
    - If investment risk is shared, then the uncertainty should be less than for a pure DB plan.

Risk-Sharing Plans: Comparison Summary

- **Assume both risk-sharing options have the same expected employer cost as the current FRS retirement system**
- Benefits for full career employees: better under combination DB + DC
- Benefits for mid-career terminations: better under cash balance
- Uncertainty of employer cost / exposure to unfunded liabilities:
    - For combination DB + DC the risk might be reduced by about 35% relative to current Pension Plan
    - For cash balance plan, uncertainty depends critically on how the interest credit provision is designed

- Uncertainty of employee benefits:
    - For combination DB + DC the risk of severe shortfall is much lower than for the current Investment Plan
    - For cash balance plan, uncertainty depends critically on how the interest credit provision is designed – but the risk will be lower than for current Investment Plan
- Ease of implementation and administration: better for combination DB + DC
- Impact on investment policy:
    - For combination DB + DC there would be no significant impact.
    - For cash balance plan, a separate investment policy from the pension plan might be needed to address liquidity needs and the interest credit requirements.

Senate Committee Action

SB 548 by Simmons re to Bullying. The bill creates a criminal statute penalizing bullying and aggravated bullying. The newly created statute provides a second degree misdemeanor penalty for bullying and a first degree misdemeanor penalty for aggravated bullying. Cyberbullying is included in each new crime. The second degree misdemeanor bullying offense will occur when a person willfully, maliciously, and repeatedly harasses or cyberbullies another person. The aggravated bullying offense will occur when a person willfully, maliciously, and repeatedly harasses or cyberbullies another person and makes a credible threat to that person. The elements of these two new offenses and the definitions provided in the bill are the same as the elements and definitions in the stalking statute.

The bill passed the Senate Criminal Justice committee as a committee substitute and is now in Appropriations.

House Committee Action

HB 159 by Berman re to Establishment of Mental Health First Aid Training. The bill requires the Department of Children and Families (DCF) to establish a mental health first aid training program (program). The program is intended to train individuals to identify and understand the signs of mental illnesses and substance use disorders and help someone who is developing or experiencing a mental health or substance use problem. The bill directs that training be provided through contract providers and that first priority for the training be given to the staff of schools.

The bill passed the House Healthy Families Subcommittee as a committee substitute. This is similar to SB 574 that is making its way through the Senate.

HB 377 by Moraitis re to Educational Facilities Financing. The bill renames the “Higher Educational Facilities Financing Authority” as the “Educational Facilities Financing Authority” and adds authorization for private, nonprofit elementary, middle, and secondary schools that are located in and chartered by the state of Florida and accredited by SACS to participate in construction financing through the authority. Accordingly, the term “institution of higher education” is replaced by the terms “educational institution” or “participating institution” throughout Part II of ch. 243, F.S. The bill makes a number of additional nomenclature changes to conform to this expansion of eligibility.
The bill expands the types of projects that the authority may finance to include:

- Costs for construction of dormitories or student housing; dining halls; student unions; administration or academic buildings; libraries; laboratories; research facilities; classrooms; athletic facilities; health care facilities; maintenance, storage, or utility facilities; and related facilities or structures required or useful for the instruction of students, research, or the operation of an educational institution, e.g., parking;
- Certain purchases of equipment and machinery; and
- A loan in anticipation of tuition revenues.

Books, fuel, supplies, or other items which are customarily deemed to be operating costs may not be financed.

The bill passed the House Choice and Innovation Subcommittee favorably. A similar bill, SB 628 has been filed in the Senate by Senator Montford.

HB 533 by M Diaz re to Student Eligibility for Interscholastic Athletics. The bill was substantially amended and expands the extracurricular activities to which a charter student is eligible to include interscholastic athletics regulated by FHSAA, intramural athletics; and fine or performing arts, speech and debate, and other academic or social clubs, teams, or activities. In addition, home school students and students enrolled in full-time virtual instruction programs are eligible to participate at any public school in the school district in which he or she resides or a public school in another school district which the student could choose to attend to participate in the expanded extracurricular activities if certain conditions are met. Moreover, public school students enrolled in a public school that does not offer a particular extracurricular activity may participate in that activity at any public school in the district in which he or she resides or a public school in another school district which the student could choose to attend pursuant to interdistrict controlled open enrollment policies if certain conditions are met.

FHSAA, in cooperation with each school board, must facilitate a program in which a middle or high school student who attends a private school must be eligible to participate in interscholastic or intramural athletics at any public middle or high school in the district in which he or she resides or at a public school in another district under certain conditions.

District school board policies regarding eligibility for extracurricular activities, including the eligibility of transfer students, must evenly apply to all students regardless of the extracurricular activity in which the student seeks to participate.

The statutes regulating FHSAA are amended to provide that if the date authorized for the beginning of practice is prior to the first day of the grading period in which the regular season games begin, the transfer deadline may not be prior to the first day of such grading period.

Finally, the bill requires that the preparticipation physical evaluation form must contain information that advises a student to complete a cardiovascular assessment that includes an electrocardiogram or EKG. The FHSAA must make available to the parent of each student literature on the importance of a preparticipation cardiovascular assessment that includes an electrocardiogram.

The bill passed the House Choice & Innovation Subcommittee favorably as a committee substitute.

HB 485 by Raburn re to Sexual Misconduct with Students by Authority Figures. Section 943.0435, F.S., lists numerous offenses that qualify a person as a sexual offender (e.g., sexual battery, lewd or lascivious offenses, video voyeurism, etc.). These offenses range from third degree felonies to capital felonies, and most are ranked between Levels 6 and Level 9 in the Offense Severity Ranking Chart.

The bill reclassifies the offenses listed in s. 943.0435, F.S., if the offense is committed by an authority figure of a school against a student of the school. The offenses are reclassified as follows:

- Third degree felonies are reclassified as second degree felonies;
- Second degree felonies are reclassified as first degree felonies; and
- First degree felonies are reclassified as life felonies.

The bill also requires a reclassified offense to be ranked one level higher in the Offense Severity Ranking Chart, and provides the following definitions:

- "Authority figure" means a person over the age of 18 employed by, volunteering at, or under contract with a school;
- "School" has the same meaning as provided in s. 1003.01 and includes a private school as defined in s. 1002.01, a voluntary prekindergarten education program as described in s. 1002.53(3), early learning programs, a public school as described in s. 402.3025(1), the Florida School for the Deaf and the Blind, the Florida Virtual School as established under s. 1002.37, and a K-8 Virtual School as established under s. 1002.415, but does not include facilities dedicated exclusively to the education of adults; and
- "Student" means a person under the age of 18 who is enrolled at a school.

The bill passed the House Criminal Justice Subcommittee as a committee substitute.

HB HEWS1 by House Higher Education & Workforce Subcommittee relates to Career Centers and Charter Technical Career Centers. The proposed committee bill authorizes career centers and charter technical career centers to offer college credit certificate programs and establishes a process by which they can seek approval from the State Board of Education (state board) to offer AAS degrees. The center must submit a notice of its intent to propose an AAS degree program to the Division of Career and Adult Education (DCAE) within the DOE and to the FCS institution within its service area. Among other requirements, the intent must include evidence that the center engaged in need, demand, and impact discussions with the FCS institution in its service area. The notice must be submitted 45 days before the proposal to offer an AAS degree program is submitted to the state board. The proposal must be submitted to DCAE, and include, at a minimum, the following:

- a description of the planning process and timeline for implementation;
- an analysis of workforce demand and unmet need for graduates of the program on a district or regional basis, as appropriate;
- identification of the facilities, equipment, and library and academic resources to be used;
- a cost analysis of creating a new AAS degree program;
- the program’s admission requirements, academic content, curriculum, faculty credentials, student-to-teacher ratios, and accreditation plan;
- the program’s enrollment projections and funding requirements;
- a description of outcome measures used to determine success;
- a plan that describes how the career center’s college credit courses will meet the equivalent faculty credentials for inclusion in the statewide course numbering system; and
- a plan of action if the program is terminated.

DCAE shall review the proposal, and the Commissioner of Education shall make a recommendation to the state board. If approved by the state board, the center must obtain accreditation as an associate-in-applied-science-degree-granting institution from an accrediting agency that is recognized by the United States Department of Education.

The center must annually, and upon request of the state board, the Chancellor of DCAE, or the Legislature, submit a status report regarding the center’s AAS degree programs. The proposed committee bill outlines specific performance and compliance indicators that must be included in the report.

The proposed committee bill authorizes a career center or a charter technical career center that offers college credit certificates or AAS degree programs to use the designation “technical college” with appropriate approval of their local school boards and accrediting agency.

The proposed committee bill renames and redefines “applied technology diploma” to “college credit certificate” to align with the centers’ authority to offer college credit. ATDs, currently offered as clock hour programs, will be converted to college credit. College credit courses may be offered by a career center only as part of a college credit certificate or AAS degree program, and faculty credentials must meet guidelines required in the state course numbering system to ensure appropriate transfer of credit.

The proposed committee bill establishes one block tuition and fees for all students enrolling in adult general education programs. This change will reduce the administrative burden on institutions to verify student residency, increase affordability, and promote access for students by eliminating cumbersome documentation requirements.

The proposed committee bill also establishes fees for college credit courses at career centers commensurate with those charged at FCS institutions.

The proposal was submitted as a committee bill by the House Higher Education & Workforce Subcommittee. The bill now has a number – HB 7057.

Next Week – February 17 – 21, 2014 – Of Special Interest

The Joint Legislative Auditing Committee is expected to consider taking action against educational and local governmental entities that have failed to take full corrective action in response to repeat audit findings.

The Senate Education Committee will consider, among other legislation, SB 790 by Senator Legg relating to Education Technology. The committee will also have a discussion of School Accountability Policy Concepts.

The Senate Community Affairs Committee will consider SB 7046 relating to the Florida Retirement System.

The Senate Education Appropriations Subcommittee will have a Student Enrollment Update on Key Policy Changes (Dual Enrollment, 1.0 FTE Policy, and Virtual Education)

The House Choice & Innovation Subcommittee will consider CIS1 relating to Charter Schools. The bill is attached.

The House Education Committee will have a Presentation by Commissioner Pam Stewart regarding accountability system recommendations. In addition, the Committee will consider HB 277 by Rep. Spano relating to Joint use of Public School Facilities.

The House Education Appropriations Subcommittee will consider HB 195 relating to Education Data Privacy and HB 313 relating to Single-Gender Public School Program. In addition, there will be a presentation/update on Workforce funding Methodology and Technology Funding Needs.