30TH ANNIVERSARY FCMAT

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM

Fiscal Oversight
Staying Out of Trouble

July 2022

Leadership

“The supreme quality of leadership is unquestionable integrity. Without it, no real success is possible.”

-Dwight Eisenhower

- Expectations for the governance team, leadership team, and especially the superintendent and CBO regarding finances:
  - Integrity
  - Accuracy
  - Alignment to Plan
  - Honesty
  - Stewardship
  - Competency
  - Credibility
  - Legal

The Tone Is Set At The Top

- Ethical leadership is the first and most important element of school district financial success
- Leaders must exhibit the characteristics they hope to engender in their staff
- There is no substitute for attitude, motivation, energy and enthusiasm – all should be organizational characteristics
- Integrity and ethics shape the entire district
- Leadership – good or bad – is emulated at all levels and becomes the expectation and organizational standard

Tone (Cont.)

- Competent leaders don’t “shoot from the hip,” they know how things should be done and they get them done
- Effective communication results in shared vision
- The organization chart is more than a document
    - Strategic planning, operational decision-making structures and financial management should follow the organizational chart
    - At the same time, teamwork is essential, and silos are harmful to organizational success
- Continuity is important – make a commitment and stick to it

Guiding Principles

- Are the allocation of resources and the expenditure of funds…
  - Right for the students, based on student need?
    - Does it promote student achievement and equity?
  - Right for the district, based on community?
    - Aligned to the adopted plan and priorities?
  - Legal?
    - Consistent with the requirements of law of regulation?
  - Fostering public trust?
    - Does the expenditure meet the expectations around integrity, credibility, stewardship?

Budget

- A budget is a plan – some would say it is make-believe land
  - The budget represents how much you anticipate your LEA will earn (revenue/source), spend (expenditures/uses), and have left over (reserves) (negative or positive) when the year is done
  - The budget should represent the policy and priorities of the organization, aligned to the Local Control and Accountability Plan (LCAP)
    - Budget is different than resource allocation; decisions about resources are reflected in the budget

Budget (Cont.)

- The budget should be based on reasonable assumptions and recognize
    - Economic cycle
    - Political cycle
    - State budget policy
- Budgets will change and will need to be revised frequently
    - One of the first signs of a troubled district is that its budget is not updated regularly during the year
- The budget should be balanced; when deficits are anticipated they should be explained, and a plan developed to correct over time

Budget (Cont.)

- LEAs should look at all funds and sources in developing a financial plan that supports the instructional plan
- LEAs should always use the most restricted resources first; keeping in mind that restrictions come in a variety of flavors – eligible uses, deadlines to spend, etc.
- Look for opportunities to mix and match funding resources to accomplish the goal
- One-time funds should be used on one-time needs – if used for recurring needs, have an exit plan

Deficit Spending

- Deficit spending is when expenditures and other uses exceed revenues and other sources
- It results in a net decrease to the fund balance
- Structural deficit spending is distinguished from deficit spending by considering only recurring items, and excluding one-time items such as unrestricted carryover
  - Structural deficits are far more concerning

Cash and Cash Flow

- Cash is the result of what actually happens – the real world
- Cash flow is the difference between the available cash balance at the beginning of a period (e.g., a month) and the available cash balance at the end of the period
  - The actual inflow and outflow of funds
  - “Cash position” is the balance at the end of the period
- Negative cash flow can be mitigated by borrowing
  - Internal funds, financial markets (TRANs), county office, county treasurer

Multiyear Financial Projections

- Financial data is just as essential as student data for making decisions
  - We are very adept at looking at the California School Dashboard and other student data to drive planning and decisions
  - We need to become adept at looking at financial data in the same way – budget, cash, projections, balance sheet, audit, comparative data, trends
- A district must have the ability to accurately reflect its net ending balance and ensure early warning of any discrepancies between budget and actual revenues and expenditures throughout the budget monitoring process
  - The first and second interim reports should provide updates of the district's projected net ending balance for the current year and multiyear projections

Multiyear Financial Projections (Cont.)

- The cause of most school district insolvencies can be traced to a bad financial decision made during prosperous times that came back to bite the district during lean financial times – exercise caution
  - Long-term impact of current decisions must be assessed and must be considered over multiple years (at least current plus two years)
  - The effects of today's operations and financial decisions are indelibly printed on the future
  - MYPs should be crafted with care and used to vet all long-term decisions
- Cash flow forecasts are another form of projection

Financial Reporting

- While school district financial reporting encompasses over 100 different reports, five of the six key reports in determining LEA fiscal condition are included in the Standardized Account Code Structure Software (SACS Software) reporting
- They include
  - Form 01 – General Fund (all versions)
  - Form 01CS – Criteria and Standards
  - Form A – Average Daily Attendance
  - Form CASH – Cash Flow
  - Form MYP – Multiyear Financial Projections
- Each of the key SACS Software reports are produced at budget adoption, interim reporting and unaudited actuals
- The sixth key report not included in SACS is the annual financial and audit report

Financial Reporting (Cont.)

- At the very least LEAs have significant fiscal review five times a year—maybe six, and all comprise official external reporting as well
  - Budget approval (June)
  - First period interim report (December)
  - Second period interim report (March)
  - Possibly a third interim report (May)
  - Unaudited actuals (September)
  - Annual audit (December/January)
- Some districts report financial data more frequently (e.g., monthly), but it is internal only

Financially Troubled District

- There are always financially troubled districts
- A financially troubled district is different than a district with indicators of moderate or high risk or potential insolvency
  - Financially troubled is focused on the financial metrics only
  - Indicators of moderate or high risk or potential insolvency include broader considerations

Financially Troubled District (Cont.)

- A financially troubled district may…
  - Have a history of deficit spending
  - Have its budget disapproved by the county superintendent
  - Have consecutive qualified or negative interim reports
  - Not be able to conform to the multiyear projection standards
  - Not have enough cash to meet its obligations in the current and next fiscal year
  - Not fully understand LCFF and LCAP
  - Be a district that cannot meet state standards on its own
  - Be a district with weak internal controls

AB 1200 Process

- Assembly Bill (AB) 1200 established the structure for financial accountability standards and the reporting and oversight process relative to LEA fiscal conditions
  - Provides for standards and criteria for fiscal accountability related to budget development and expenditures (EC 33127 and 33128)
  - Requires regular and uniform budgetary and financial reporting
  - Requires public disclosure of certain events and conditions
  - Recognizes that the first level of oversight rests with each LEA’s governing board and provides for a secondary and external level of oversight by the county (or state) superintendent
  - Provides for a receivership process for districts that cannot meet their financial obligations

AB 1200 Process (Cont.)

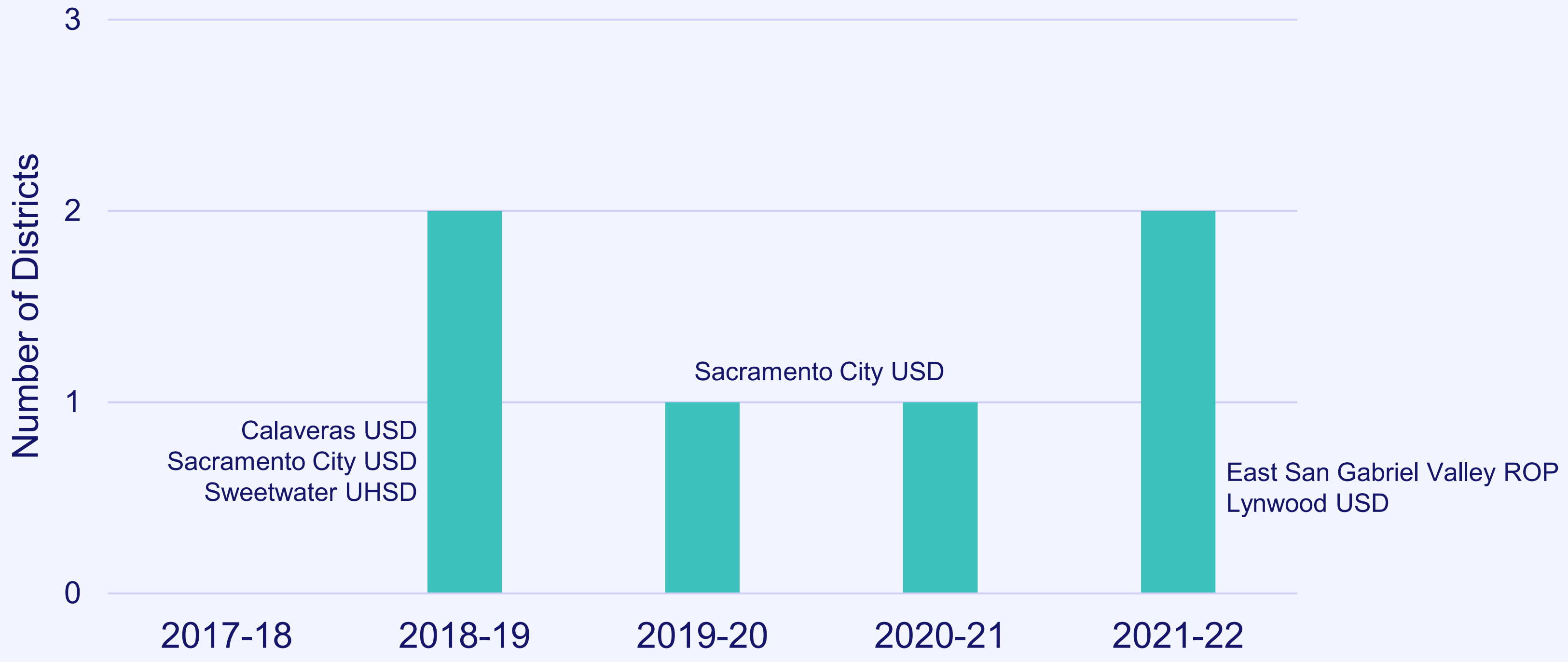
- The foundations of the AB 1200 process assume the school district and their oversight agency are aligned regarding the facts and goals, and work together to improve fiscal conditions
- AB 1200 created FCMAT
  - Initially focused on fiscal crisis
  - Evolved to spend 80% of its efforts on the prevention of crisis, through professional development and management assistance

Budget Approval

- At budget approval (July) – EC 42127
  - The county superintendent must examine the adopted budget for compliance with standards and criteria, and other applicable statutory requirements and determine to <u>approve</u>, <u>approve with conditions</u> or <u>disapprove</u> a district's budget
  - September 15 deadline for initial written determination
  - If conditionally approved or disapproved, district has until October 8 to respond
  - Subsequent county superintendent review must be made by October 22 and November 8; only approved or disapproved status may remain as of November 8

Disapproved Budgets

There were two preliminarily disapproved budgets for the 2021-22 fiscal year; both were subsequently approved.

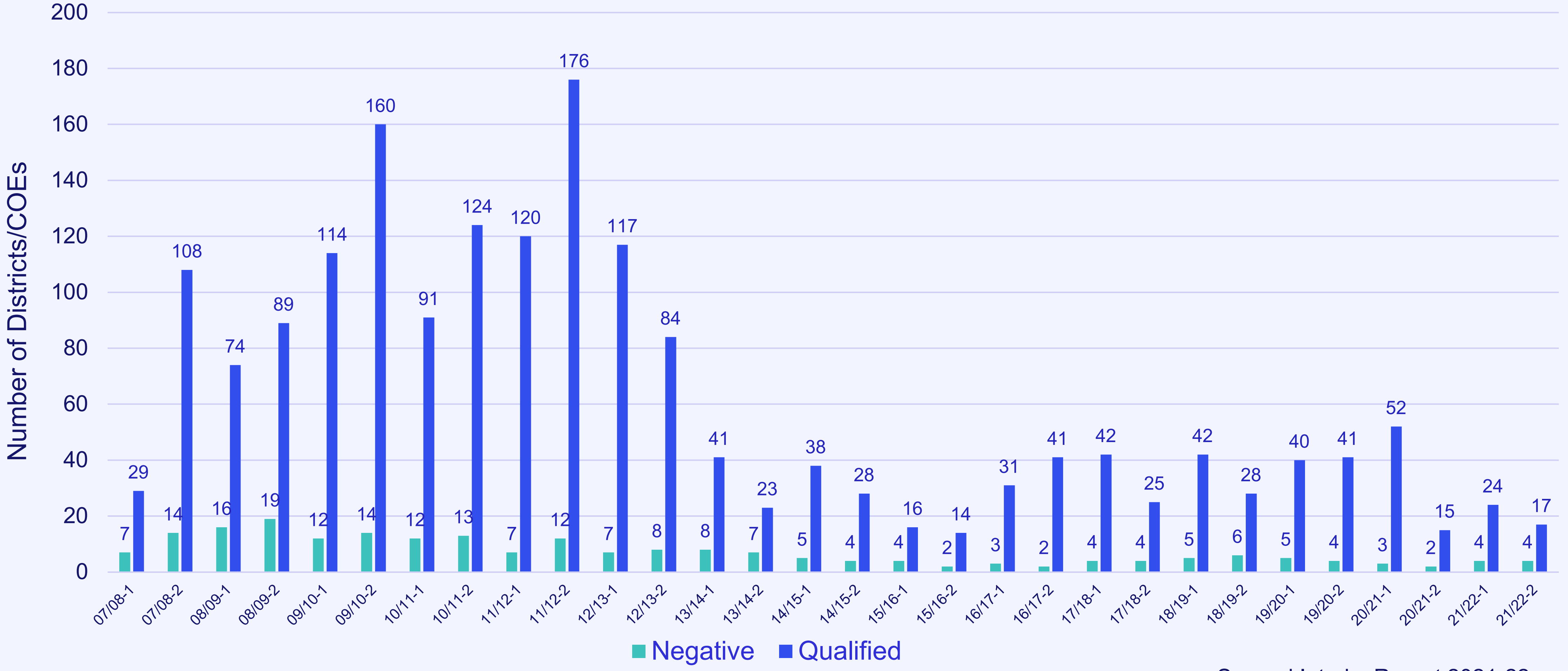


As of 2021-22 Budget Adoption reviews (11/08/2021)

Interim Report Certifications

- At interim reports (December 15 and around March 15) – EC 42130 & 42131
  - District's governing board self-certifies positive, qualified or negative
  - A district is positive when it is determined that it will meet its financial obligations in the current and two subsequent years
  - A district is qualified when it is determined that it may not be able to meet its financial obligations in the current and two subsequent years (budget)
    - The number of qualified districts generally ebbs and flows with the state budget, but some districts may show signs of chronic conditions
  - A district is negative when it is determined that it will not meet its financial obligations in the current and next fiscal year (cash)
    - The number of negative districts is fairly consistent over time

Historical Qualified & Negative Certifications



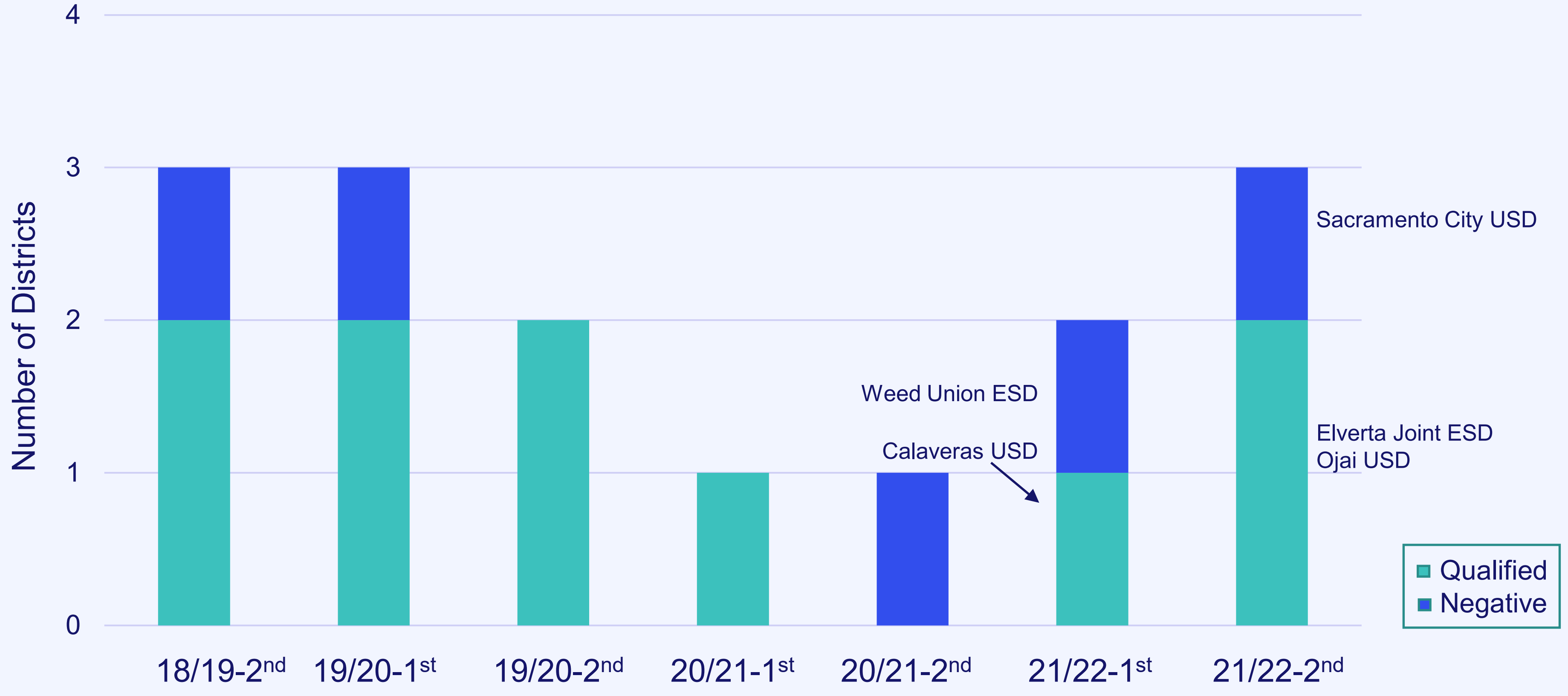
Second Interim Report 2021-22 as of April 20, 2022

Interim Report Certifications (Cont.)

- At interim reports – EC 42131
  - If after examination of the interim report, the county superintendent disagrees with a district's self-certification – e.g., determines a qualified certification when a positive certification was submitted, or determines a negative certification when a qualified certification was filed
    - FCMAT labels this a downgrade in interim certification
  - County superintendent should make this determination within 30 days of the interim report deadline (e.g., January 15, around April 15) and issue its findings in writing

Downgraded Interim Report Certifications

Interim reports that have certifications downgraded by the county superintendent are included in the total count of qualified and negative reports.



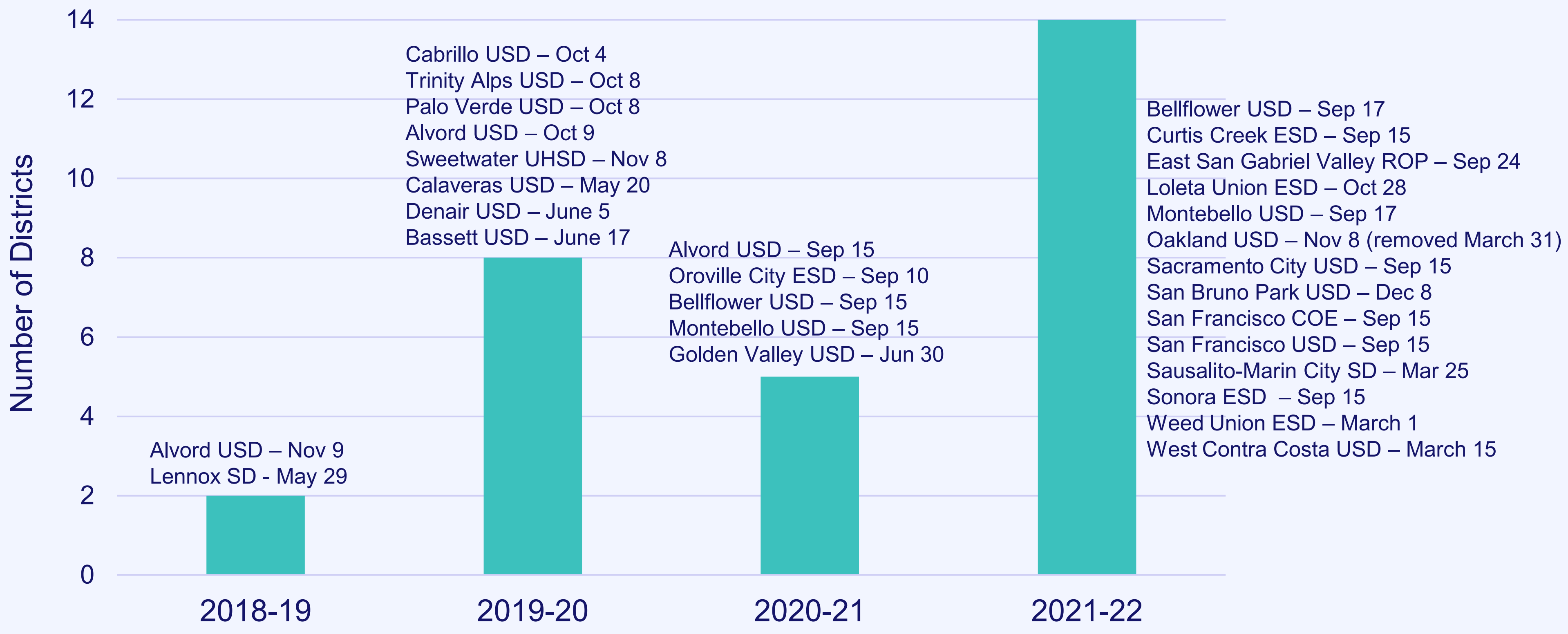
Second Interim Report 2021-22 as of April 20, 2022

Lack of Going Concern

- At any time – EC 42127.6
  - If the county superintendent determines that a district may be unable to meet its financial obligations for the current or two subsequent fiscal years, the county superintendent shall provide written notice of going concern determination, including the basis of determination
    - FCMAT labels this a lack of going concern
  - The designation remains in place up to the point the county superintendent approves the district's budget for the subsequent fiscal year
  - The basis of determination may be broader than just typical financial metrics, e.g., internal controls, leadership, facilities, non-voter-approved debt
    - See: FCMAT's Indicators of Risk or Potential of Insolvency

Lack of Going Concern Designations

A record 14 districts/COEs have been designated as a lack of going concern in 2021-22 for a variety of budget and nonbudget concerns.



Education Code 42127.6

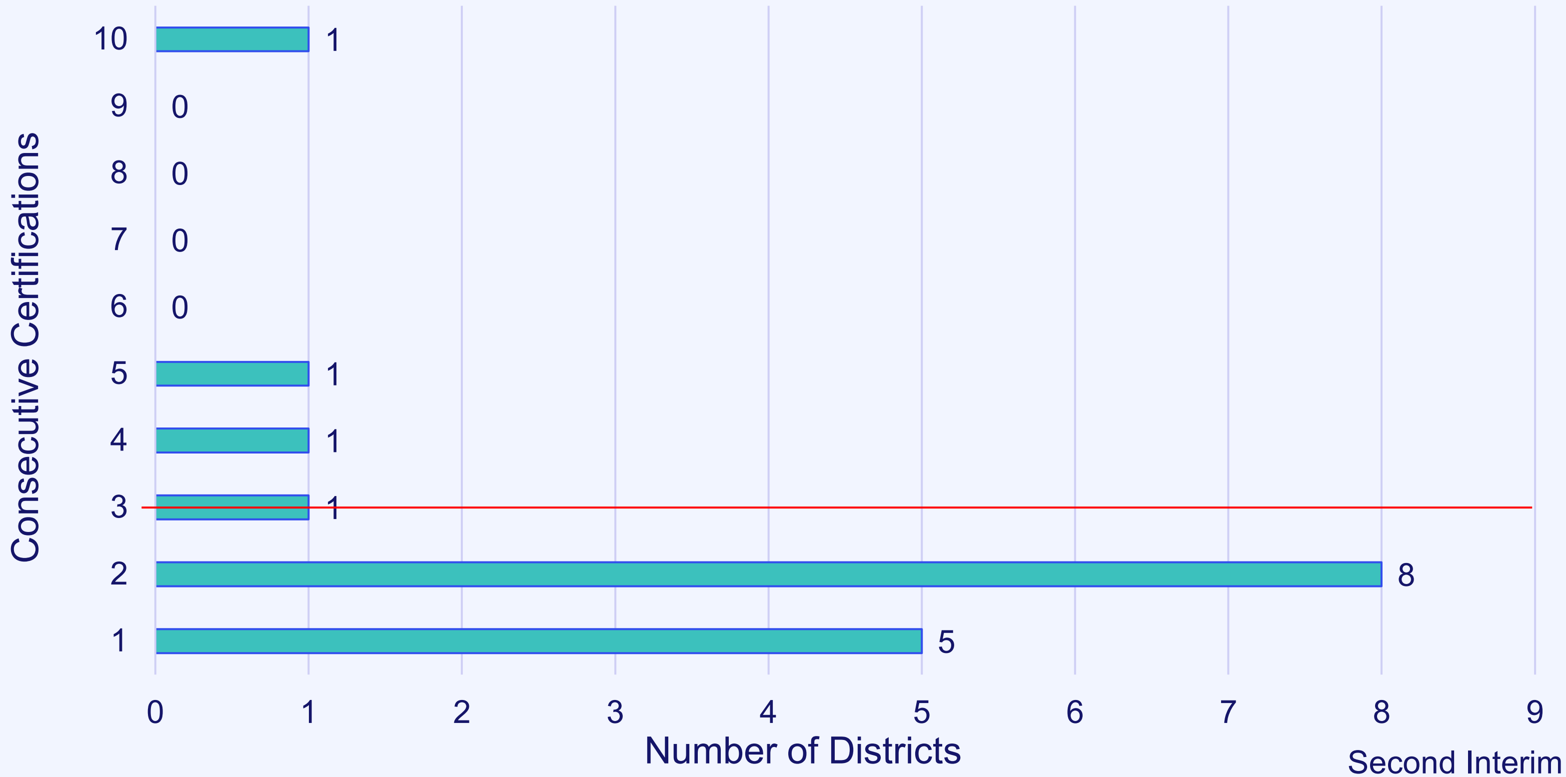
As of March 31, 2022

Additional Criteria

- FCMAT considers additional criteria when reporting and engaging with districts in fiscal distress
  - Consecutive qualified or negative interim report certifications provide additional insight
  - Number of times a district has been qualified or negative over ten interim reports (tracked internally and not reported)

Qualified Interim Report Certifications

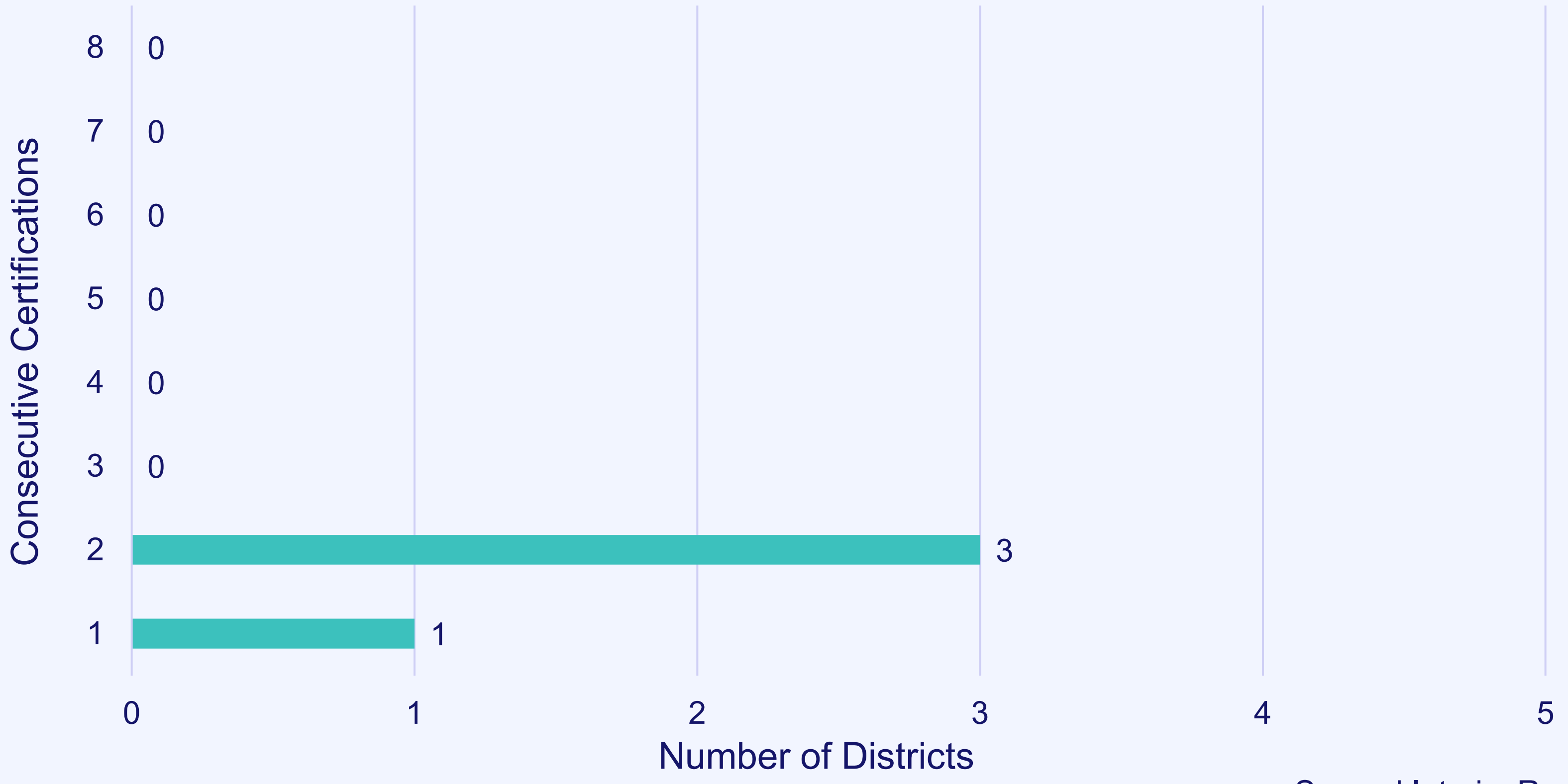
Of the 17 qualified districts, four have three or more consecutive qualified certifications over the past ten reporting periods.



Second Interim Report 2021-22 as of April 20, 2022

Negative Interim Report Certifications

Two of the four negative certifications continue to have significant challenges.



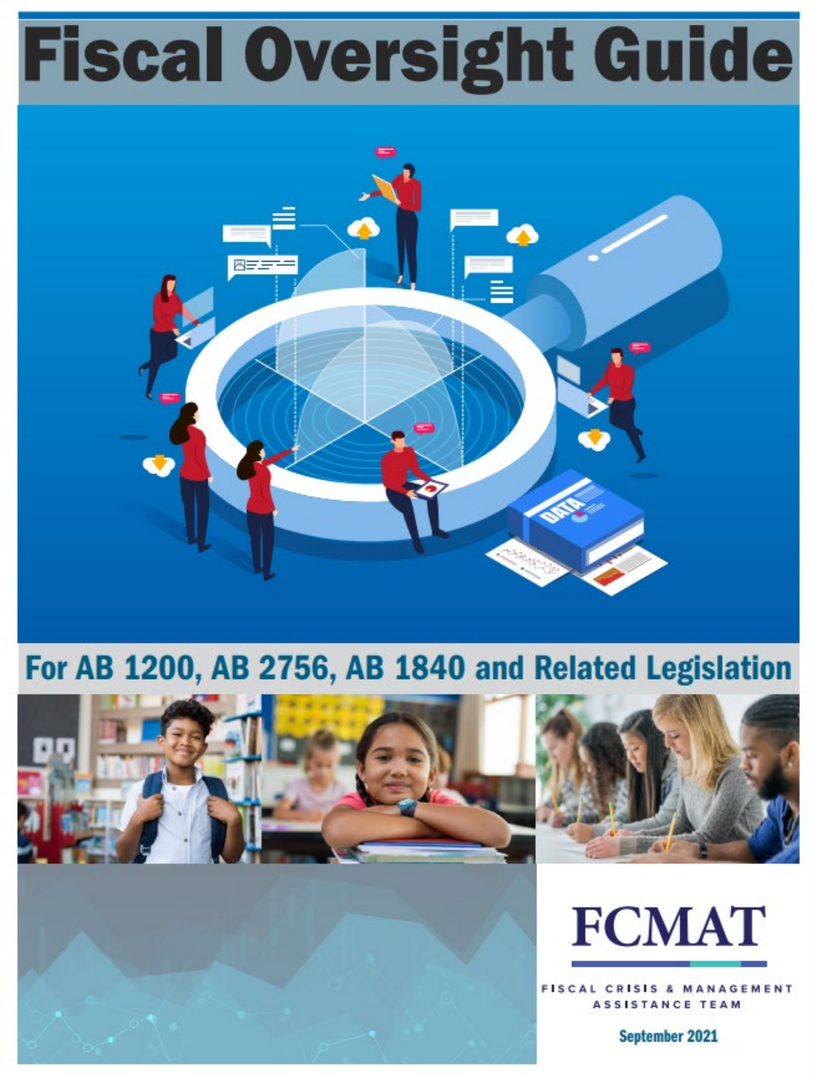
Second Interim Report 2021-22 as of April 20, 2022

Fiscal Oversight Guide

- The “AB 1200 Process” encompasses many statutory provisions enacted over 30 years
- The overarching provisions and steps of LEA fiscal oversight are covered in the FCMAT Fiscal Oversight Guide
  - The guide is available at:

    https://www.fcmat.org/publicationsreports/fiscal-oversight-guide-2021.pdf
  - FCMAT also offers a two-day training on fiscal oversight; sample materials are at:

    https://sites.google.com/view/fiscal-oversight-training



Intervention

- As part of the second level of oversight, AB 1200 authorizes the county superintendent to follow a progression of investigation, findings, notification, appellate review, intervention, further findings and further appellate review and further interventions (EC 42127.6)
  - Support school districts with information and collaborative assistance
  - Appoint a fiscal expert or fiscal advisor
  - Stay and rescind authority over decisions made by the district's governing board if the board's action is inconsistent with the ability of the district to meet its financial obligations for the current or subsequent fiscal year
  - Additional stringent measures

Applicable to Superintendent of Public Instruction for county superintendents and "single/single" county/districts

Intervention (Cont.)

- The county superintendent determines the level of intervention and corrective action needed
  - Intensity of intervention is progressive and can be tailored to the severity of the problem
- The goal of county superintendent intervention is to assist the district in resolving its financial problem at the lowest level of outside intervention
- Open, honest cooperation equates to the right amount of help – help the county superintendent help you
  - The system is built on a presumption of cooperation

Applicable to Superintendent of Public Instruction for county superintendents and “single/single” county/districts

Automatic Engagement

- FCMAT considers the following criteria in deciding to proactively engage with districts showing signs of fiscal distress
  - Disapproved budget
  - Negative interim report certification
  - Three consecutive qualified interim report certifications
  - Downgrade of an interim report certification by county (state) superintendent
  - Lack of going concern designation

Tools to Determine the Level of Distress

- FCMAT publishes and uses the following tools to assist districts in assessing the level of fiscal distress
  - Indicators of Potential Risk of Insolvency
  - Fiscal Health Risk Analysis
    - 130 yes/no questions across 20 areas, weighted to determine high, moderate or low risk (EC 42127.6(c)(2))
- These are companions to the standards and criteria for fiscal accountability adopted by the State Board of Education
- Both provide an outline of the available basis of determination of fiscal distress

Versions of these tools exist for traditional K-12, charter schools and community college districts.

Determining Fiscal Risk

High Risk	High Risk	Medium Risk
Budget Development and Adoption	Fund Balance and Reserve for Economic Uncertainty	Special Education
Budget Monitoring and Updates	General Fund – Current Year	**Low Risk**
Cash Management	Information Systems and Data Management	Annual Independent Audit
Collective Bargaining Agreements	Internal Controls and Fraud Prevention	Charter Schools
Contributions & Transfers to Other Funds	Leadership and Stability	Facilities
Deficit Spending	Multiyear Projections	
Employee Benefits	Non-Voter-Approved Debt and Risk Management	
Enrollment and Attendance	Position Control	

What Happens If Your District Gets Into Financial Trouble?

- The first line of defense – district (locally governed agency)
- The second line of defense – intervention by county superintendent
  - Fiscal expert or fiscal advisor
- The third line of defense – state (emergency appropriation by legislature)
  - County administrator (formerly state administrator)
  - County trustee (formerly state trustee)
- FCMAT is a partner at each stage
  - Management assistance (district's request)
  - Automatic engagement (triggered based on conditions)
  - Statutory role (emergency appropriation)

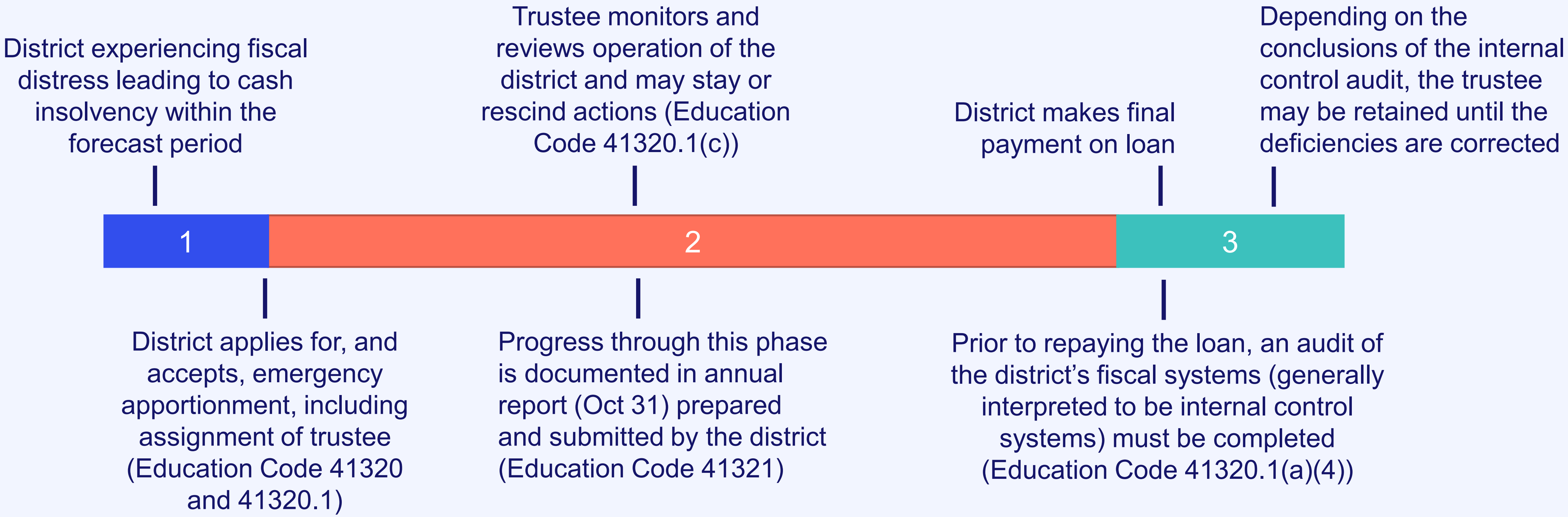
Cash Insolvency

- Cash insolvency occurs when payroll expense exceeds available cash in the county treasury, and all options for borrowing have been exhausted
  - Immediate: You cannot make payroll
  - Short term: You cannot meet your financial obligations for the current and next fiscal year
- Cash insolvency is a function of deficit spending, erosion of fund balance, and sustained negative cash flow over time
- Cash is king! Cash shows no mercy!
  - Cash insolvency is the end of the road – game over – and is usually the trigger point for an emergency appropriation which may result in governance changes

The Consequences of Cash Insolvency

- District’s governing board may ask for and receive an authorization for an emergency appropriation, but…
    - District will lose superintendent and local governance (>200% loan)
    - Budget cuts will still need to be made, but even more than before
    - It’s expensive
    - It is not a bailout – it is a cash loan to assist in paying the district’s obligations
- Most likely in an insolvency the district’s fiscal situation gets worse, not better, in the near term
    - Bleeding from the original wounds continues, plus the district now has additional costs, including debt service on the emergency appropriation

Phases of Recovery Under Receivership – Loan Equal to or Less Than 200%



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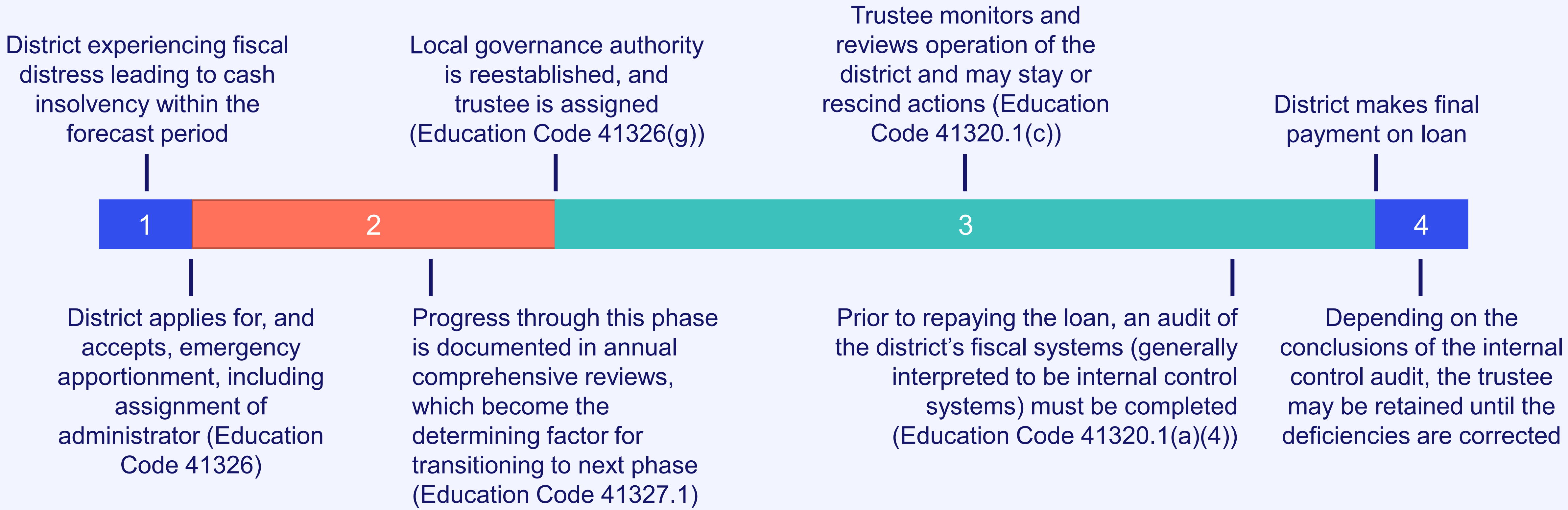
Phases of Recovery Under Receivership – Loan Greater Than 200%



This graphic is for illustration purposes only.

Getting Out of the Mess

- Characteristics of districts that…

Make a Successful Turnaround	That Require Severe Measures
Recognize they have a problem	Deny they have a problem
Don't mask the problem	Resist scrutiny from outsiders
Take advantage of financial expertise available	Don't seek external assistance
Work collaboratively with oversight agencies	Combative with oversight agencies
Are part of the solution	Are part of the problem

- Governance and leadership created the mess; they can contribute or hinder the turnaround.

Deeper Dive

Ways Districts Get in Trouble

- The following slides provide a deeper dive on the most common ways districts get in trouble
- These topics represent many key variables
  - Each district has its own personality and history; therefore, the reasons for unaddressed fiscal issues vary
  - Districts with qualified interim report certifications generally represent short-term budget related variables which are addressed in the near term
    - The conditions may look like what other districts are experiencing
  - Districts with negative interim report certifications generally represent longer-term unaddressed difficulties
    - The conditions are often unique to the district

Ways Districts Get in Trouble - Economics

- Estimates of State Economics
  - Exposure: *Significant*
  - Professional Standard
    - Understand state economic forecasts
    - Anticipate effect on your district
    - Build local budget and MYP assumptions on the state numbers
  - Definition
    - State economics determine state revenue which determines allocations under Proposition 98 to school districts

Ways Districts Get in Trouble - ADA

- Average Daily Attendance (ADA)
  - Exposure: *Critical*
  - Professional Standard
    - The district must have policies and procedures in place to appropriately forecast and monitor enrollment and ADA (caseload)
  - Definition
    - Enrollment drives costs
    - ADA drives revenues
    - ADA is equal to the average number of students actually attending classes on a given day

Ways Districts Get in Trouble - Assumptions

- Budget Assumptions
  - Exposure: *Critical*
  - Professional Standard
    - The district budget must be based on a foundation of verifiable and clearly stated assumptions for both revenue and expenditures
    - Budgets must be aligned to the LCAP
  - Definition
    - Assumptions are the building blocks of a budget and stand in place of facts until those facts are known

Ways Districts Get in Trouble - Positions

- Position Control
  - Exposure: *Critical*
  - Professional Standard
    - Utilize a position control system to ensure discipline over staffing costs within the parameters adopted by the board
  - Definition
    - Position control factors in the number of staff, pay rates, assignments, overtime, hours/year calendars, and benefits adopted by the board. Position control involves the business office, HR and payroll, and the reconciliation of each

Ways Districts Get in Trouble – Step & Column

- Estimating Step and Column
  - Exposure: *Critical*
  - Professional Standard
    - Districts must have tools and procedures to estimate the annual increase in salary and benefits incurred each year as a result of step and column movements by staff
  - Definition
    - Step: dollar change between salary steps based on years of service
    - Column: dollar change between salary columns based on educational units or other collectively bargained criteria

Ways Districts Get in Trouble – One-Time $

- Use of One-Time Funds
  - Exposure: *Significant*
  - Professional Standard
    - Recurring expenses must be covered by recurring revenues
    - One-time funds should not be used for recurring expenses
  - Definition
    - One-time funds include ending balances, audit adjustments, retroactive revenues, unrestricted carryover and other non-recurring revenues/sources

Ways Districts Get in Trouble - Negotiations

- Negotiations
  - Exposure: *At least significant, and likely critical, but could be minor*
  - Professional Standard
    - Maintain comparable compensation and working conditions within the district's ability to pay
    - Balance compensation needs with student needs
    - Know the cost of 1%
    - Lack of adequate disclosure
  - Definition
    - Collective bargaining is required by the Rodda Act

Ways Districts Get in Trouble - MYP

- Multiyear Projections (MYP)
  - Exposure: *Critical*
  - Professional Standard
    - The long-term (at least 2 years) implications of current decisions must be assessed, understood and considered in budget planning
  - Definition
    - Multiyear projections consider the out-year impact of today's decisions on the district's financial stability (ending fund balance, deficit spending and cash flow considerations)

Ways Districts Get in Trouble - Budget

- Execution of the Budget

  - Exposure: *Significant*
  - Professional Standard
    - The district must only expend funds within the authority of the adopted budget
    - Revisions to the budget should be approved as necessitated prior to being implemented
  - Definition
    - While budgets are built upon assumptions, they are the legal spending plan and must be adhered to

Ways Districts Get in Trouble - Monitoring

- Monitoring of the Budget
  - Exposure: *Critical*
  - Professional Standard
    - AB1200 requires districts to monitor actual results in relationship to the adopted budget
    - Perform a self-assessment regarding results and trends
  - Definition
    - Monitoring of the budget is an element of accountability and transparency and is a routine process of comparing actual results with the adopted budget as revised from time to time

Ways Districts Get in Trouble - Deficits

- Deficit Spending
  - Exposure: *Critical*
  - Professional Standard
    - The budget should be balanced
    - All deficit spending should be planned, monitored and explained
  - Definition
    - Deficit spending is a sign that the district is spending beyond its means. The deficit may be for a legitimate, planned purpose; or it may be structural in nature and require correction

Ways Districts Get in Trouble – Fund Balance

- Estimating the Ending Fund Balance
  - Exposure: *Critical*
  - Professional Standard
    - A district must have the ability to accurately estimate its net ending fund balance throughout the budget monitoring process
  - Definition
    - Estimated ending fund balance is the foundation of the beginning fund balance for the new year. This estimate is updated with unaudited actuals and then audited actuals

Ways Districts Get in Trouble - Cash

- Cash Management
  - Exposure: *Critical*
  - Professional Standard
    - Districts must project cash balances monthly and prepare appropriate cash flow schedules to assess the need for short-term borrowing and potential cash insolvency
  - Definition
    - Cash position represents the actual available funds at any given time held in the county treasury (different from budget)

Ways Districts Get in Trouble – Student Data

- Student Data
  - Exposure: *Critical*
  - Professional Standard
    - The requirement for districts to properly collect, manage and report student data to the state via CALPADS and P1, P2 and annual ADA reports is a critical responsibility influencing the district’s revenues and performance data; data quality is essential
  - Definition
    - Timely periodic reporting of quality data from districts forms the basis for both appropriations (ADA and demographics) and performance reporting (demographics, attendance, discipline, assessment, placement, graduation)

Ways Districts Get in Trouble – LCFF & LCAP

- Local Control Funding Formula & Local Control Accountability Plan
  - Exposure: *Critical*
  - Professional Standard
    - The LCAP is created and updated through an authentic engagement process that includes a thorough review of data
    - The LCAP includes locally minded goals and actions with thoughtful metrics for evaluation
    - The budget is aligned to the LCAP
  - Definition
    - LCFF and LCAP were designed to create a nexus between program and resources with an ultimate focus on student achievement