FCMAT

FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM

Staying Out of Trouble

Fall 2020

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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 LCAP
  - The budget should be based on reasonable assumptions

Budget (cont.)

- 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

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

What is 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

What is Cash Insolvency?

- Cash insolvency occurs when payroll expense exceeds available cash in the county treasury, and all options for borrowing have been exhausted
- 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 and the resulting changes in governance

The Consequences of Cash Insolvency?

- You have negative cash flow
- Your options for borrowing are exhausted
- You cannot meet your financial obligations for the current plus next fiscal year
- You cannot make payroll

The Consequences of Cash Insolvency? (cont.)

- You can receive an authorization for an emergency appropriation, but…
  - You will lose your superintendent and local governance
  - Budget cuts will still need to be made, but even more than before
  - It’s expensive
- Most likely in an insolvency your fiscal situation gets worse, not better, in the near term

Multiyear Financial Projections

- A district must have the ability to accurately reflect its net ending balance throughout the budget monitoring process
- Long-term impact of current decisions must be assessed and must be considered over multiple years (at least current plus two years)
- The first and second interim reports should provide updates of the district's projected net ending balance
- The district should have tools and procedures that ensure an early warning of any discrepancies between the budgeted and actual revenues and expenses

Positives, Qualifieds, Negatives and all that Stuff – Or…the AB 1200 Process

- At the <u>very least</u> you will have significant fiscal review five times a year—maybe six:

  - Budget approval
  - First period interim report
  - Second period interim report
  - Possibly a third interim report
  - Unaudited actuals
  - Annual audit

Positives, Qualifieds, Negatives and all that Stuff – Or…the AB 1200 Process (cont.)

- AB 1200 (EC 42127) sets financial standards for school districts and includes enough “teeth” to ensure adequate oversight is possible
  - It is possible that the “teeth” are not used consistently across the state, but the standards are uniform
- AB 1200 was enacted to help school districts avoid insolvency through a progressive process of interventions and actions
- AB 1200 created the Fiscal Crisis and Management Assistance Team

Positives, Qualifieds, Negatives and all that Stuff – Or…the AB 1200 Process (cont.)

- AB 1200 empowered county superintendents with fiscal oversight to follow a progression of interventions:
  - Support school districts with information and collaborative assistance
  - Lower a self-certification from positive to either qualified or negative, or a qualified to negative (downgrade)
  - Designate a district a lack of going concern
  - Appoint a fiscal expert or more stringent measures

Positives, Qualifieds, Negatives and all that Stuff – Or…the AB 1200 Process (cont.)

- The COEs are the “second line of defense” to protect the state from liability for a school district’s financial problems and ensure that the LCFF and LCAP are in alignment
- Not adhering to the standards and criteria is likely to spoil your whole day

It’s Not Just About Interim Certifications

- Interim report certifications are a long-established criteria for reporting and beginning appropriate oversight intervention by a COE
  - Negative interim report certification
  - Three consecutive qualified interim report certifications
- FCMAT considers additional criteria when reporting and engaging with districts in fiscal distress
  - Disapproved budget
  - Downgrade of an interim report certification by COE/CDE
  - Lack of going concern (EC 42126.7)

What is a Financially Troubled District?

- A financially troubled district:
  - May have a history of deficit spending
  - May have its budget disapproved by the county superintendent
  - May have consecutive qualified or negative interim reports
  - May not be able to conform to the multi-year projection standards
  - May not have enough cash to meet its obligations in the current and next fiscal year

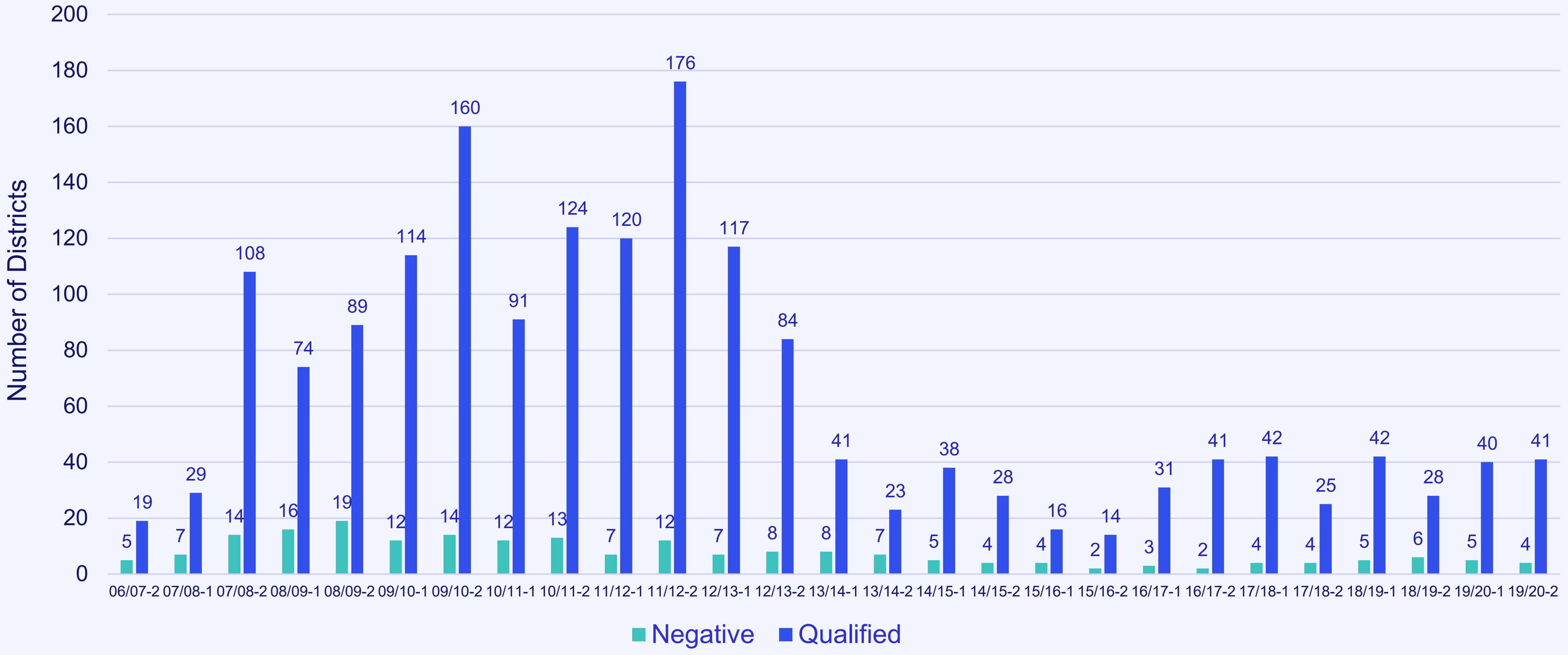
What is a Financially Troubled District? (cont.)

- A financially troubled district:
  - May not fully understand LCFF and LCAP
  - May be a district that cannot meet state standards on its own
  - May be a district with weak internal controls
  - There are always financially troubled districts

What is a Financially Troubled District? (cont.)

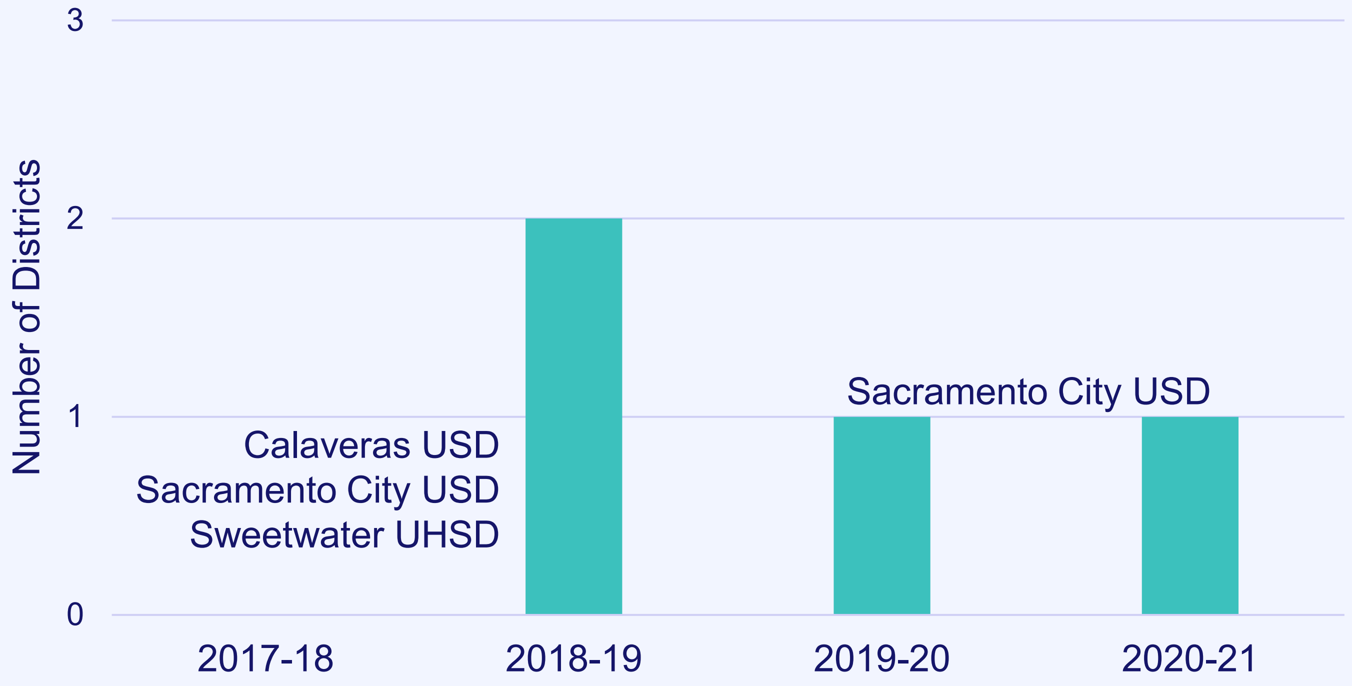
- Normally district fortunes rise and fall in tandem with state economics, but some are chronic
  - A district is qualified when it is determined that it may not be able to meet its financial obligations in the current and two subsequent years (budget)
    - The number of qualified districts generally ebbs and flows with the state budget
  - 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 Interim Report Certifications



Disapproved Budgets

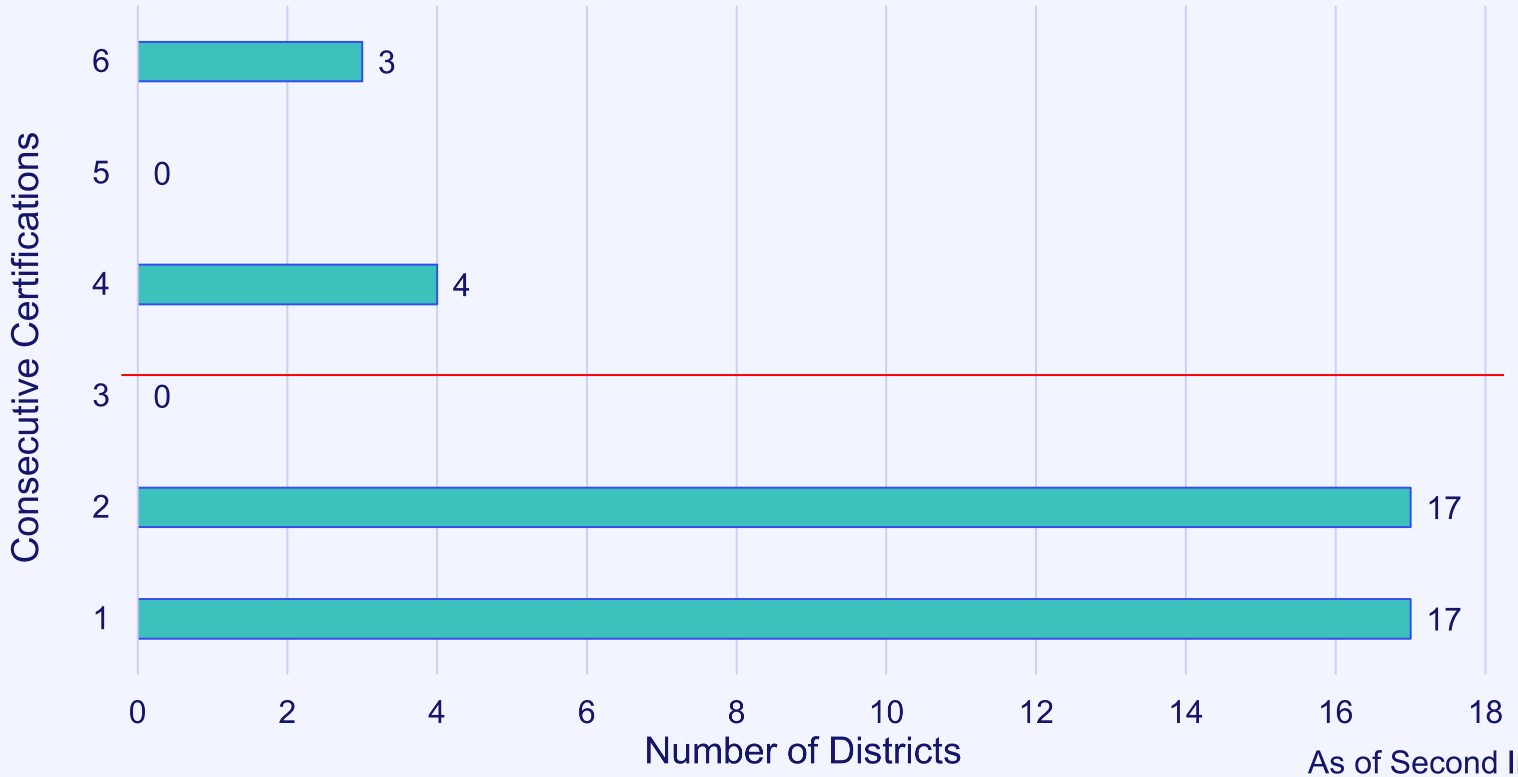
The one disapproved budget in 2020-21 represents the district's third consecutive disapproved budget.



As of 2020-21 Budget Adoption reviews, October 5, 2020

Qualified Interim Report Certifications

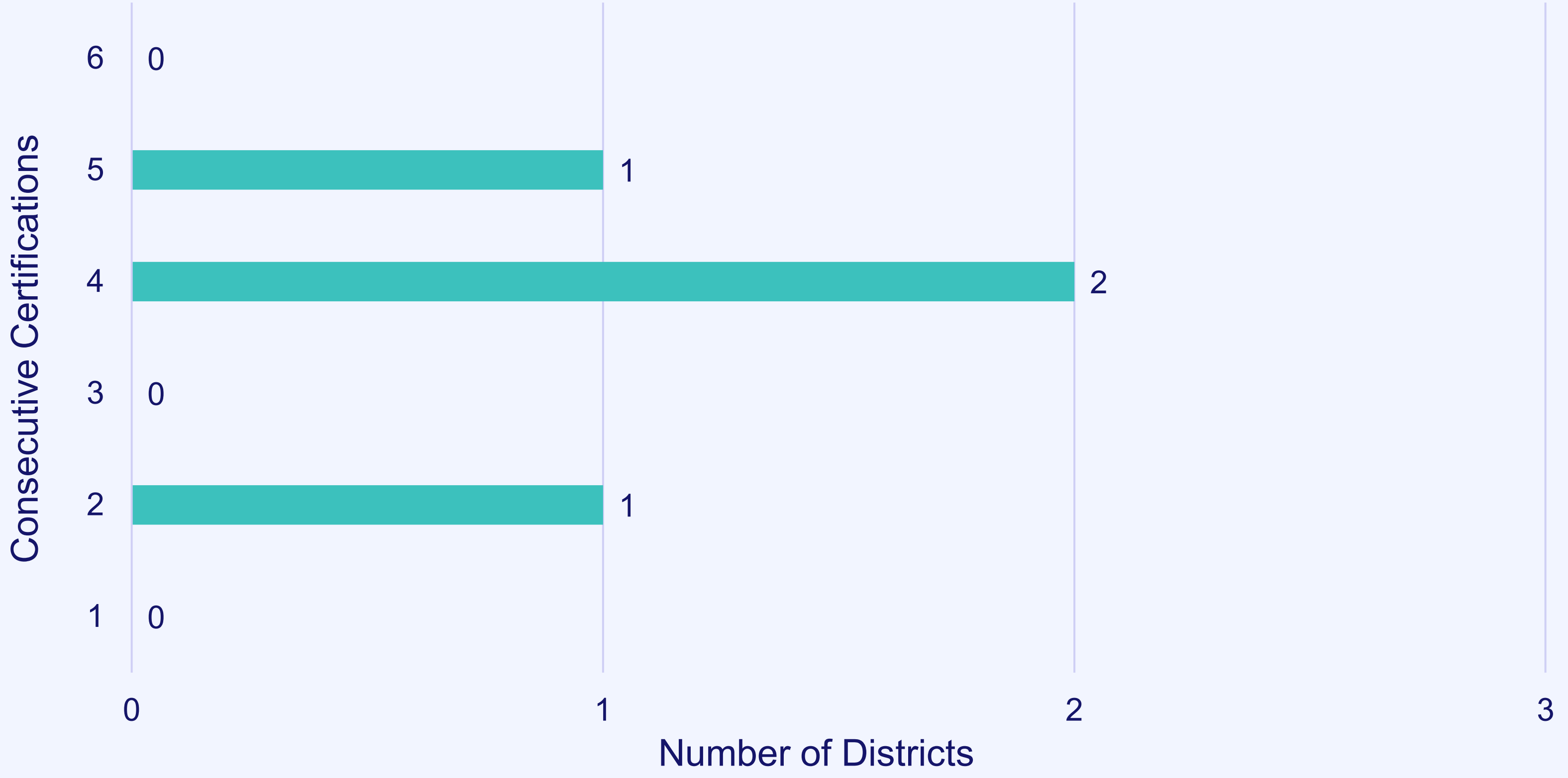
Of the 41 qualified districts, seven have three or more consecutive qualified certifications over the past six reporting periods. Two are qualified as a result of a downgrade in certification by their county superintendent.



As of Second Interim Report 2019-20 "Pre-COVID-19"

Negative Interim Report Certifications

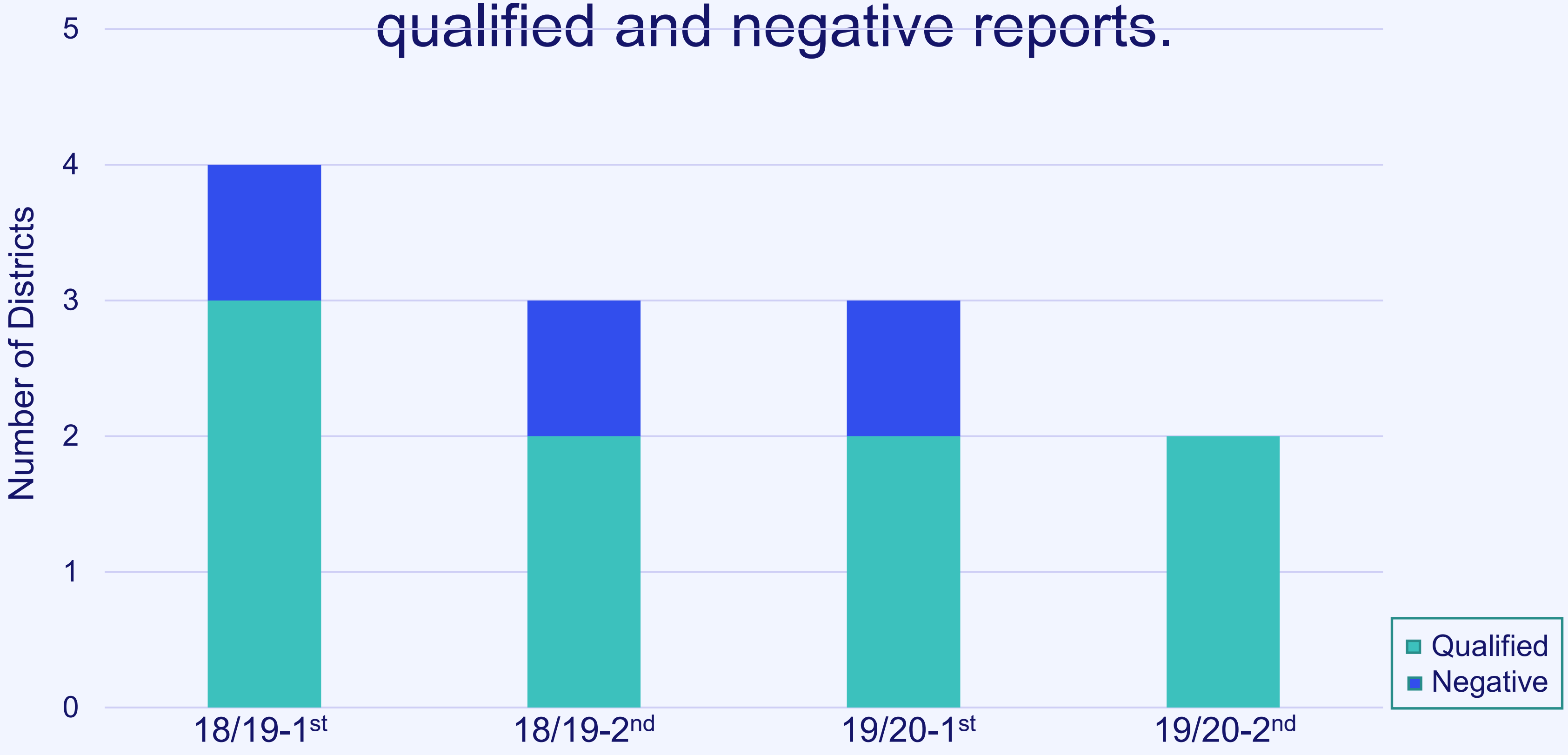
Of the four negative districts, three have four or more consecutive negative certifications over the past six reporting periods.



As of Second Interim Report 2019-20 “Pre-COVID-19”

Downgraded Interim Report Certifications

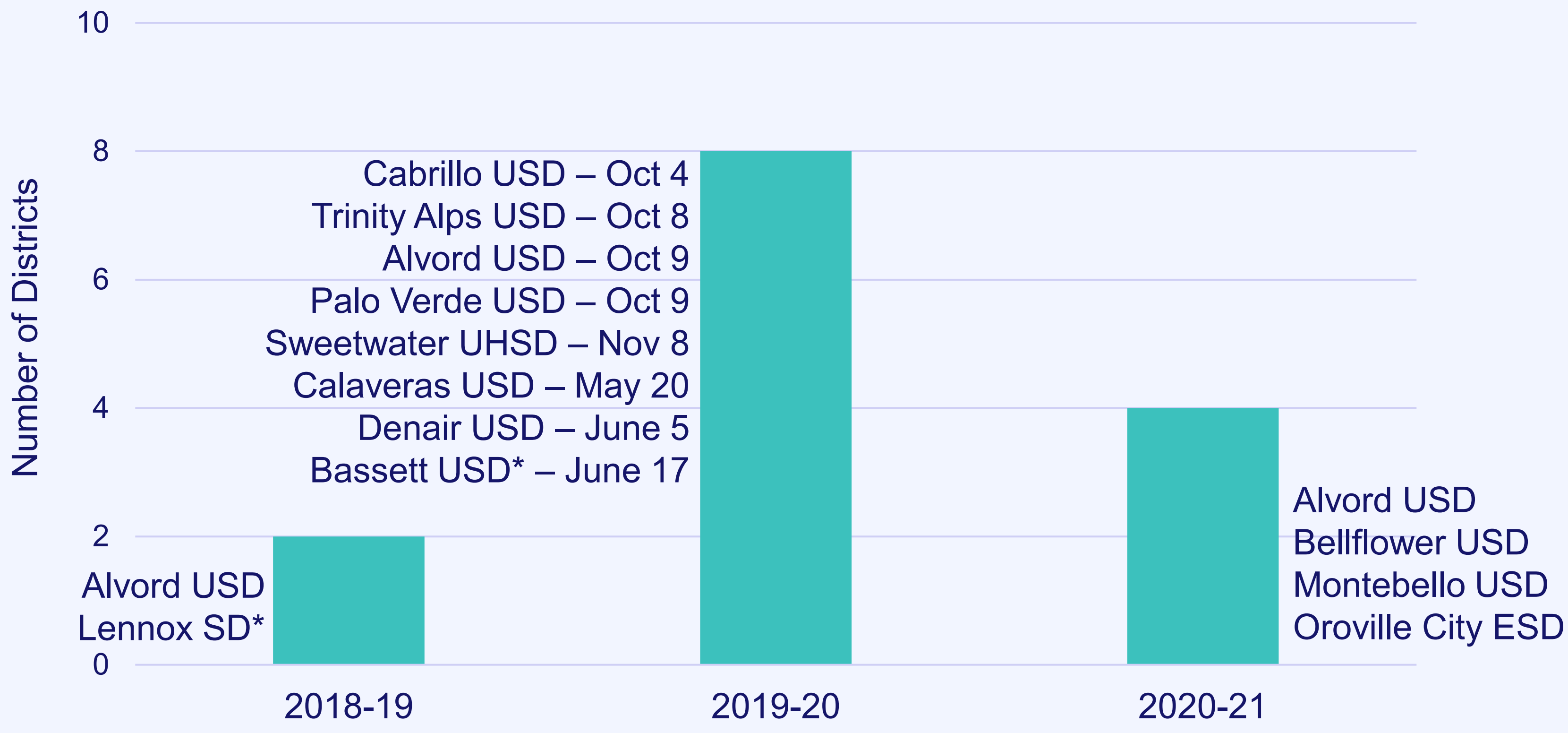
Interim reports that have certifications downgraded by the county superintendent are included in the total count of qualified and negative reports.



As of Second Interim Report 2019-20 “Pre-COVID-19”

Lack of Going Concern Designations

Four districts have been designated as a lack of going concern in 2020-21 for non-budget concerns, such as leadership, lack of disclosure and non-compliance.



As of October 22, 2020

*LACOE considers Lennox and Bassett as continuing LGC status in 2020-21

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 Planning (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 considers 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 (LCFF) & Local Control Accountability Plan (LCAP)
  - 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

What Happens If Your District Gets Into Financial Trouble?

- The first line of defense – the district (YOU, the team)
- The second line of defense – intervention by the county superintendent
- FCMAT is a partner
- Responsibilities of a fiscal expert or fiscal advisor
- Responsibilities of a county administrator (formerly state administrator)
- Responsibilities of a county trustee (formerly state trustee)

County Superintendent Intervention

- Intensity of intervention is progressive and can be tailored to the severity of the problem
- The county superintendent determines the level of intervention and corrective action needed
- 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

Applicable to SPI for COEs and “single/single”

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 standardized account code system (SACS) criteria and standards adopted by the State Board of Education

Versions of these tools also exist for charter schools and community college districts.

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.

Character Counts

- "The supreme quality of leadership is unquestionable integrity. Without it, no real success is possible." (Eisenhower)
- Expectations for the governance team, leadership team, and especially the superintendent and CBO regarding finances:
  - Integrity
  - Honesty
  - Commitment
  - Accuracy

Questions?

Thank You!