Indicators of Risk or Potential Insolvency

For California TK-12 Local Educational Agencies

The Fiscal Crisis and Management Assistance Team (FCMAT) has compiled the following list of indicators of risk or potential insolvency based on more than 30 years of experience with local educational agencies (LEAs) since the inception of Assembly Bill (AB) 1200 in 1991. This list will continue to be revised to ensure it remains relevant and helpful.

Each indicator signifies a lack of function, commitment or attention to one or more critical elements of an LEA's operations. The existence of any one of these indicators increases the risk of insolvency and the need for assistance from outside agencies. Lack of attention to these critical areas will eventually lead to fiscal insolvency and loss of local control.

Identifying issues early is the key to maintaining fiscal health. Diligent multiyear planning, proactive risk assessment and accurate cash flow projections enable LEAs to better understand their financial objectives and to develop strategies to sustain a high level of fiscal effectiveness and overall solvency. LEAs should discuss these indicators regularly and complete a Fiscal Health Risk Analysis (FHRA) periodically, if not annually, to assess their fiscal health risk and progress. The FHRA for transitional kindergarten through grade 12 (TK-12) districts is available at: www.fcmat.org/fiscal-health.

1. **Inattention to Annual Independent Audit**
    - Most recent and/or two prior audit reports include material apportionment and/or internal control findings
    - Most recent and/or prior two audit reports include material weakness findings
    - Failure to correct findings in most recent and/or prior two audit reports
    - Failure to complete and present most recent audit report to the board within statutory timelines

2. **Inadequate Budget Development and Adoption**
    - Unreasonable and/or unclear budget assumptions
    - Reliance solely on prior-year rollover budget method
    - County superintendent disapproved or conditionally approved the budget within the last two years
    - Failure to correctly calculate Local Control Funding Formula (LCFF) revenue
    - Reliance on carryover funds
    - One-time sources used for ongoing expenditures
    - Failure to align the budget with Local Control and Accountability Plan (LCAP) expenditures
    - Failure to use position control data
    - Failure to solicit input from the budget advisory committee, community, board, administrators and staff during budget development
    - Failure to prioritize expending restricted funds before unrestricted funds
    - Failure to adopt and file the LCAP and budget with the county superintendent of schools within statutory timelines

- Negative and/or contra accounts used for expenditures other than appropriate abatements and Standardized Account Code Structure (SACS) objects 5700s and 7300s
- Lack of a documented policy and/or procedure for evaluating the proposed acceptance of grants and other types of restricted funds and their potential multiyear impact on the unrestricted general fund
- Failure to adopt and/or follow a budget calendar

3. **Insufficient Budget Monitoring and Updates**
   - Failure to regularly update budget assumptions
   - Actual revenues and expenditures not consistent with the most current budget
   - Failure to post budget revisions in the financial system routinely and/or to communicate them to the board regularly
   - Failure to produce timely and accurate financial information
   - Inadequate explanations to criteria and standards variances and changes
   - Failure to regularly reconcile balance sheet accounts in the general ledger
   - Lack of clearly written and articulated budget assumptions to support budget revisions at each interim report
   - Failure to complete budget revisions following board approval of collective bargaining agreements
   - Failure to address deficiencies noted in the county superintendent of schools' oversight letters
   - Requisitions and/or purchase orders processed when the budget is not sufficient
   - Failure to encumber and adjust encumbrances for salaries and benefits
   - Failure to make necessary budget revisions to reflect board-approved compensation increases before the next financial reporting period
   - Failure to adopt and file interim financial reports and unaudited actuals within statutory timelines

4. **Inadequate Cash Management**
   - Failure to reconcile county treasurer and bank (cash and investment) accounts monthly
   - Failure to project cash flows for the current fiscal year and the subsequent year
   - Lack of a reasonable plan to address cash flow needs
   - Lack of communication to board about the LEA's cash position (with a clear distinction between cash and fund balances)
   - Insufficient cash resources in other funds to meet current and projected obligations in those funds
   - Failure to comply with Education Code (EC) requirements when interfund borrowing is occurring

- Failure to include repayment of borrowed external and internal funds in cash flow projections

5. Unmonitored Charter Schools

- Inadequate and/or undocumented monitoring and oversight of authorized charters
- Lack of a board policy or other written document regarding charter oversight
- Lack of evidence showing the LEA fulfilled its charter oversight responsibilities
- Authorized charters are in fiscal distress
- Failure to identify a specific staff member to be responsible for the oversight of all authorized charters

6. Mismanaged Collective Bargaining Agreements

- Failure to consider and adequately quantify the fiscal impact of compensation increases or collective bargaining agreements and/or failure to include their effects in the budget and multiyear projections (MYPs)
- Failure to conduct thorough and/or timely analyses of proposed compensation increases or settlements
- Settlements (including step-and-column costs) above the funded cost-of-living-adjustment (COLA) for the current and prior two fiscal years
- Failure to comply with the public disclosure requirements under EC 42142 and Government Codes 3540.2 and 3547.5, including adequate explanations/answers to disclosure questions
- Collective bargaining agreements not certified for public disclosure by superintendent and/or chief business official (CBO) before board approval
- Board approval of collective bargaining agreements not consistent with the superintendent's and CBO's certifications
- Failure to identify resources to cover the fiscal impact of compensation increases or collective bargaining agreements
- Failure to settle with all bargaining units in the past two years
- County superintendent analysis expresses concern about the fiscal impact of tentative/approved collective bargaining agreements and/or inadequacy of disclosure details regarding the LEA's disclosure of fiscal impacts
- Compensation increases or settlements (including step-and-column costs) above the funded COLA for the current and prior two fiscal years

7. Increasing and/or Uncontrolled Contributions and Transfers

- Insufficient control and monitoring of contributions/transfers to other restricted programs and/or funds
- Lack of a board-approved plan to eliminate, reduce or control contributions/transfers to other restricted programs and funds

- Failure to make unrestricted general fund transfers when needed to cover projected negative fund balances in other funds
- Contributions/transfers to restricted programs and/or other funds not budgeted and/or not included in the MYPs

8. Continued Deficit Spending (Unrestricted General Fund)

- Deficit spending in the current or two subsequent fiscal years
- Lack of or failure to implement a board-approved plan to reduce and/or eliminate deficit spending
- Failure to decrease deficit spending over the past two fiscal years

9. Mismanaged Employee Benefits

- Failure to complete actuarial valuations in accordance with Governmental Accounting Standards Board requirements to determine the unfunded liability for other post-employment benefits
- Lack of a board-adopted plan to fund health and welfare retiree benefit liabilities, if applicable
- Lack of or failure to comply with a policy or collective bargaining agreement to limit accrued vacation balances
- Failure to verify benefit eligibility of all employees, retirees and dependents within the last five years
- Failure to track, reconcile and/or report compensated leave balances

10. Inattention to Enrollment and Attendance

- Decreasing and/or unstable enrollment and/or average daily attendance (ADA)
- Failure to monitor and analyze enrollment and ADA data at least monthly
- Enrollment and/or ADA projections and assumptions not based on historical data, industry standards, and other reasonable considerations
- Failure to monitor and/or plan for the effects of enrollment losses to charter schools
- Lack of or failure to comply with a board policy on interdistrict transfers
- Failure to maintain staffing ratios and class size requirements, resulting in financial penalties

11. Inattention to Facilities

- Lack of an accurate long-range facilities master plan
- Failure to meet required contributions to the Routine Restricted Maintenance Account, if applicable
- Lack of sufficient and available capital outlay and/or bond funds to cover all contracted obligations for capital facility projects

- Failure to track and account for facility-related projects
- Failure to use facilities fully in accordance with the Office of Public School Construction's loading standards
- Failure to include facility needs (e.g., maintenance, repair, and operating requirements) in the adopted budget
- Failure to meet Williams Act facility inspection requirements and/or to resolve outstanding issues
- Failure to meet the audit, reporting, and citizens' bond oversight committee requirements for Proposition 39 general obligation bonds, if applicable

12. Inadequate Fund Balance and Reserve for Economic Uncertainty

- Failure to accurately estimate the ending fund balance
- Failure to maintain the minimum reserve for economic uncertainty in the current and two subsequent years
- Lack of a board-approved plan to restore the minimum reserve for economic uncertainty, if applicable
- Failure to include assigned or committed reserves above the recommended reserve level in the unrestricted fund balance when one-time costs or unfunded or contingent liabilities exist
- Unstable or decreasing projected unrestricted fund balance

13. Mismanaged General Fund – Current Year

- Lack of control or monitoring of total compensation costs
- Uniform complaints or legal challenges regarding the use of supplemental and concentration grant funding
- Failure to use restricted funds fully within required timelines
- Failure to account for program costs, including maximum allowable indirect costs, for each restricted resource and other funds

14. Nonintegrated Information Systems and Data Management

- District's and county office of education's financial systems not integrated
- Financial and human resources systems not integrated
- Failure to use systems to provide the financial and personnel data needed to make informed decisions
- Lack of capacity or failure to maintain accurate and consistent data across all systems (e.g., student information, human resources, food services, and special education)
- Failure to review, verify, correct and certify California Longitudinal Pupil Achievement Data System (CALPADS) data before submission deadlines
- Inaccurate data consistently reported to CALPADS and other state agencies

- Failure to accurately identify students who are eligible for free and reduced-price meals, English learners and/or foster youth, in accordance with the LCFF and LCAP
- Lack of emergency data recovery systems
- Failure to conduct regularly scheduled tests of the security measures that protect students' and employees' personal information

15. Ineffective Internal Controls and Fraud Prevention

- Lack of controls that limit access to the financial system
- Failure to update financial system access and authorization upon employment actions (e.g., resignations, terminations, promotions and demotions) and/or failure to review system access and authorization at least annually
- Lack of segregation, supervision and/or monitoring of duties in accounts payable, accounts receivable, purchasing, contracts, payroll and/or human resources
- Failure to post and reconcile beginning balances for the new fiscal year with the ending balances from the prior fiscal year
- Failure to review and clear prior year accruals by the first interim reporting period
- Lack of adequate processes and procedures to discourage and detect fraud
- Lack of an independent fraud reporting service (e.g., an anonymous hotline) and lack of a process for following up on such reports
- Lack of an internal audit process

16. Weaknesses in Leadership and Stability

- Frequent turnover in the CBO and/or superintendent positions (incumbents have been with the LEA less than two years)
- Lack of regular communication among the superintendent and all administrative cabinet members
- Failure to provide timely training on financial management, budget and governance to the school and department administrators responsible for budget management and decision making
- Failure to follow, adopt, update, implement and/or communicate board policies and administrative regulations
- Micromanagement by board members
- Systems fully or partially controlled by highly influential special interest groups
- Failure to train board members in budget and governance at least every two years
- Failure to perform the superintendent's evaluation according to the terms of their contract

17. Inadequate Multiyear Projections

- MYPs not in accordance with reasonable outyear assumptions, fiscal stabilization plan (if any), and long-term commitments

- Insufficient restricted funds to pay for staff and lack of a plan to fund these positions with unrestricted funds
- Failure to explain trend analyses
- Failure to prepare LCFF calculations with multiyear considerations
- Failure to consider most recent MYP when making financial decisions
- Failure to include detailed information when using “other adjustments” (lines B10, B1d and B2d) on the SACS MYP

18. Inattention to Non-Voter-Approved Debt and Risk Management

- Non-voter-approved debt repayment sources are unstable and/or unpredictable
- Downgrade of credit rating within the current and two prior fiscal years
- Outdated actuarial study (more than two years old) and/or lack of a plan to pay for any unfunded liabilities when self-insured
- Non-voter-approved debt (e.g., bridge financing, bond anticipation notes, certificates of participation, and revenue anticipation notes) with total annual debt service payments greater than 2% of the LEA’s unrestricted general fund revenues

19. Lack of Position Control

- Incomplete accounting of all positions and costs
- Failure to analyze and/or adjust staffing based on staffing ratios and enrollment
- Failure to regularly reconcile budget, payroll and position control
- Failure to identify budget sources for new positions before board approval
- Failure to obtain board approval before posting new positions and extra assignments
- Failure to adopt and/or follow staffing ratios for certificated, classified and administrative positions
- Lack of regular meetings among human resources, payroll and budget staff to discuss issues and improve processes

20. Unmonitored Special Education

- Failure to monitor special education costs and/or contribution rate above the statewide average
- Failure to align special education staffing ratios, class sizes and caseloads with statutory requirements and industry standards
- Failure to access available funding sources for special education costs
- Failure to use appropriate tools to make informed decisions regarding whether to add services
- Failure to budget and/or account for all special education costs
- Identification rate of students as eligible for special education is above the countywide and/or statewide averages
- Failure to analyze and/or meet maintenance of effort requirement at each financial reporting period