

## 2020-21 Adopted Budget Review

This fiscal alert addresses factors and recommended approaches county offices of education should take into account when reviewing local educational agencies' (LEAs') 2020-21 adopted budgets in light of the current uncertainty about subsequent year planning and lack of metrics to use for analysis. Additionally, recent budget trailer bill legislation makes changes to relevant Education Code sections.

Although this alert is intended mainly for county superintendents to use in their fiscal oversight role, all LEAs may have an interest in FCMAT's recommendations as they continue to update their budgets and multiyear projections in the coming months.

While county superintendents may exercise considerable discretion in making final determinations about an LEA's budget, the Education Code provides a minimum set of standards that work well under normal circumstances. However, in the current period of economic instability, substantive planning assumptions are not present for the two subsequent years (years two and three of the multiyear projection). Because of the volatility and uncertainty of subsequent year assumptions, FCMAT recommends that year one of the multiyear projection (the 2020-21 budget) be used as the basis for the budget approval determination, with recommendations related to fiscal risks identified in years two and three. Despite the lack of substantive planning assumptions, there is little question that significant financial challenges exist for 2021-22 and 2022-23.

This guidance is critical during these unprecedented times to ensure consistency in how budgets are analyzed and how financial plans are developed and updated moving forward. It is essential that early warnings of fiscal distress in an LEA be noted and responded to promptly with the appropriate level of technical assistance and intervention. County superintendents are responsible for providing such assistance and intervention, and may call upon other resources, including FCMAT, to assist. In order to prioritize assistance and intervention, county superintendents will need to have a thorough understanding of each LEA's financial details and areas of risk and opportunity. If LEA budgets and projections are not transparent and thoughtful, the task of providing assistance will be much more difficult. In addition, without transparency, LEAs' administrators and board members will find it difficult to make sound decisions.

### FCMAT

Michael H. Fine  
Chief Executive Officer

1300 17<sup>th</sup> Street - CITY CENTRE  
Bakersfield, CA 93301-4533  
Telephone 661-636-4611  
Fax 661-636-4647

755 Baywood Drive,  
Second Floor  
Petaluma, CA 94954  
Telephone 707-775-2850  
[www.fcmat.org](http://www.fcmat.org)

Administrative Agent  
Mary C. Barlow  
Office of Kern County  
Superintendent of Schools

## Education Code Requirements

As a reminder, for budgets submitted on July 1, the county superintendent shall:

- Examine the adopted budget for compliance with the state criteria and standards adopted by the State Board of Education (SBE) pursuant to Education Code section 33127 and identify technical corrections necessary to bring the budget into compliance [E.C. 42127(c)(1)].
- Determine if the budget allows the district to meet its financial obligations and is consistent with a financial plan that will enable the district to satisfy its multiyear financial commitments [E.C. 42127(c)(2)].
- Ensure that the budget reflects the estimated unaudited revenues, cash balances and expenditures for the year just ended [E.C. 42103(c)].
- Ensure that the budget reflects a complete plan and itemized statement of all estimated revenues and expenditures for the next fiscal year as well as a comparison of revenue and expenditures for the current year [E.C. 42122].
- Ensure that the budget includes expenditures sufficient to implement the specific actions and strategies included in the LCAP adopted by the governing board of the school district or the annual update to the LCAP, based on the projections of the costs included in the plan [E.C. 42127(c)(3) and 52070(d)(2)]. *(Not applicable for 2020-21)*
- Ensure that the budget is on forms prescribed by the State Superintendent of Public Instruction (SPI) [E.C. 42123].
- Ensure that if the budget includes designations of fund balance or an unappropriated fund balance, the funds are available for appropriation by a majority vote of the governing board [E.C. 42125].
- Determine whether the budget includes a combined assigned and unassigned ending fund balance that exceeds the minimum recommended reserve for economic uncertainties, and if so, verify that the district complied with the requirements of Education Code sections 42127(a)(2)(B) and (C) [E.C. 42127(c)(4)].
- Review and consider studies, reports, evaluations, or audits of the district that contain evidence of fiscal distress under the criteria and standards, or a finding by an external reviewer of moderate or high risk based on the most common predictors of a district needing intervention [*newly revised* E.C. 42127(c)(2)].
- Either conditionally approve or disapprove a budget that does not provide assurances that the district will meet its current and future obligations and resolve problems identified in studies, reports, evaluations, or audits described above [E.C. 42127(c)(2)].

Per E.C. 42127(d)(1), on or before September 15, the county superintendent shall approve, conditionally approve, or disapprove the adopted budget for each school district. As that deadline looms closer, FCMAT is providing guidance on the second bulleted item above: Determine if the budget allows the district to meet its financial obligations and is

consistent with a financial plan that will enable the district to satisfy its multiyear financial commitments.

### **Considerations for Review**

The determination of a school district's solvency is based in some measure on both county office staff's knowledge of a specific district's situation and history, and the district's historical trends. Important questions include:

- a) Does the district have a history of submitting a balanced budget that was later determined to have deficiencies?
- b) Has the district been able to adequately project average daily attendance (ADA) in recent years?
- c) Does the district have a history of underestimating certain categories of expenditures?
- d) Does the district usually make a significant number of errors in preparing its budget?
- e) Does the district have an adequate position control system?
- f) Do district staff understand the internal controls that affect the district's budget development?
- g) Has the district included unsubstantiated budget reductions in its multiyear financial plan (e.g., amounts on line B10)?

When reviewing a district's adopted budget, FCMAT recommends that its Fiscal Health Risk Analysis (FHRA) be used. The full FHRA can be found at <https://www.fcmat.org/fiscal-indicators>. The questions and sections in the FHRA are based on the common indicators of risk or potential insolvency for districts that have neared insolvency and needed assistance from outside agencies. The FHRA results in a risk assessment score that corresponds with the levels of risk used in recently revised statute [E.C. 42127(c)(2)].

Certain questions in the FHRA carry increased weight because they indicate conditions that are known to elevate a district's overall risk rating. These factors should be considered as part of the county office's evaluation of risk. Lack of attention to these critical areas could lead to a district's failure, especially in light of the economic uncertainties LEAs are facing today.

### **FHRA Conditions that Elevate Risk Rating**

- The district's budget has not been approved unconditionally by its county office of education for the two prior fiscal years.
- Following board approval of collective bargaining agreements, the district did not make necessary budget revisions in the financial system to reflect settlement costs before the next financial reporting period.
- The district has not addressed deficiencies the county office of education has identified in its oversight letters in the prior two fiscal years.

- The district does not forecast its cash receipts and disbursements at least 18 months out, updating the actuals and reconciling the remaining months to the budget monthly to ensure cash flow needs are known.
- The district lacks a reasonable plan to address cash flow needs during the current fiscal year.
- The district has one or more charter schools in fiscal distress but has not performed its statutory fiscal and operational oversight functions, including the issuance of formal communication to the charter, such as notices of violation.
- The district has not fulfilled and does not have evidence showing fulfillment of its charter oversight responsibilities in accordance with Education Code section 47604.32.
- The district has not accurately quantified the effects of collective bargaining agreements and included them in its budget and multiyear projections in the prior two fiscal years.
- The district did not conduct a presettlement analysis and identify related costs or savings, if any (e.g., statutory benefits, and step and column salary increase), in the subsequent years, and/or did not identify ongoing revenue sources or expenditure reductions to support the agreement.
- The district has deficit spending in funds other than the general fund but has not included in its multiyear projection any transfers from the unrestricted general fund to cover any projected negative fund balance.
- The district has deficit spending in the current or two subsequent fiscal years, but the board has not approved and implemented a plan to reduce and/or eliminate deficit spending.
- The district's enrollment projections and assumptions are not based on historical data, industry-standard methods, and other reasonable considerations.
- The district lacks sufficient and available capital outlay and/or bond funds to cover all contracted obligations for capital facilities projects.
- The district is unable to maintain the minimum reserve for economic uncertainty in the current year (including Funds 01 and 17) as defined by criteria and standards.
- The district is unable to maintain the minimum reserve for economic uncertainty in the two subsequent years.
- The district is not able to maintain the minimum reserve for economic uncertainty, and its multiyear financial projection lacks a board-approved plan to restore the reserve.
- The district does not account for all positions and costs.

## 45-Day Budget Revision

No later than 45 days after the state budget is signed by the governor, the district must make available for public review any revisions made necessary by the Budget Act [E.C. 42127(h)]. In 2020-21, the 45<sup>th</sup> day is August 13. In many years, budget revisions have not been necessary because the May Revision and the final adopted budget have been closely aligned. However, for the 2020-21 fiscal year, the differences between the May Revision and the final adopted budget are significant and a 45-day revision is necessary. The 45-day revision is required for all LEAs, and county superintendents should insist that each LEA complete a full budget, multiyear projection and cash flow that reflect the final Budget Act and related trailer bill language. This will allow the county office of education to consider the revised information as part of the 2020-21 adopted budget review and approval process.

## Multiyear Financial and Cash Flow Projections

Best practice is to update multiyear financial projections (MYFPs) frequently, especially as assumptions change in the budget building blocks. The most recent official update to MYFPs was during the budget adoption process, which was based on the May Revision. Many conditions have changed since then, and assumptions for both the current and subsequent years are different. It is best practice to update MYFPs to reflect current and forecasted conditions as they change.

Once the 45-day revision is completed for the 2020-21 budget, it is vital to ensure that realistic assumptions are used for the subsequent years of the MYFP as well. For 2021-22 and 2022-23, little is known other than that apportionment deferrals are likely to remain at high levels, significant one-time resources available in 2020-21 will have expired, and growth in Proposition 98 funding will be limited. A county office should be cautious about disapproving a budget based on year two and year three issues. Rather, first interim updates will be vital because improved planning factors will likely be available by then. Given the limited planning factors, it is reasonable that county superintendents request from LEAs resolutions that acknowledge the challenges that lie ahead and reaffirm commitments to addressing budgetary challenges and fiscal solvency when more accurate assumptions become available. Adopting a resolution is a short-term option in lieu of preliminary detailed multiyear budget adjustments and signals an LEA's recognition that there is fiscal uncertainty and a commitment to address it. By issuing a resolution, a governing board can emphasize its intent to fulfill its fiduciary duty to maintain fiscal solvency in the current and two subsequent years, pursuant to Education Code section 42127, until adequate information is known to adopt detailed budget adjustments.

A sample resolution is included with this alert.

Because subsequent-year planning factors are considerably more uncertain than normal, LEAs will need to continue using the most recent information available when planning for the future. FCMAT recommends that for the subsequent years, flat funding (suspended COLA) be applied until planning factors change, likely by first interim. This baseline approach of flat funding is supported by the limited information available. Although a

single baseline forecast may suffice for formal reporting purposes, LEAs' planning efforts need to be developed around multiple scenarios that start with the baseline and produce a range of best- and worst-case considerations, all of which would be at lower funding levels than the baseline.

Cash deferrals are in essence an IOU from the state, and they must be reflected in an LEA's multiyear and cash flow projections. Without sufficient cash reserves and an ability to eschew deficit spending to preserve those reserves, an LEA may become cash insolvent. All cash borrowing options must be discussed and considered.

## Conclusion

Although the adopted state budget eliminated most proposed revenue reductions to LEAs for 2020-21, it leaves significant challenges ahead for California's educational agencies. Most 2020-21 LEA budgets were adopted before the final state budget was negotiated and signed; thus, LEAs need to make significant changes to their adopted budgets within 45 days. While it is customary to make such budget updates, it is less customary for updates to be made to MYFP and cash flows. County superintendents should insist that LEAs update their budgets, MYFPs and cash flows, and county superintendents should consider these updates in their evaluation of LEAs' adopted budgets when determining approval status.

Adding to the challenge is a lack of data and common agreement on what the future of the economy, and specifically state revenues, hold for 2021-22 and 2022-23. Assumptions of flat funding for these years will make preparing a reasonable MYFP difficult but are nonetheless realistic and prudent. Absent planning factors, LEAs must assume that baseline funding is flat, that the significant apportionment deferrals continue, and that one-time funding provisions expire. Although LEAs should be building other budget scenarios for planning purposes, county offices need to take the lack of planning factors into account when analyzing MYFPs and determining approval status based on subsequent year data.

Maintaining fiscal solvency while maximizing services to students with available financial resources will be a continuing challenge. LEAs must realize that the economic impacts from COVID-19 will extend beyond 2020-21. LEAs' governing boards have a fiduciary duty to ensure fiscal solvency. Transparent financial details, multiyear planning, risk assessment and multiyear cash flows are critical to understanding an LEA's fiscal distress. Candid, robust conversations and appropriate, early assistance and intervention by county offices and others will help to mitigate a spike in disapproved budgets and negative certifications on interim reports. This information is not only vital to county offices but also needs to be discussed publicly to educate and engage all stakeholders about the financial implications of the pandemic on California's public school system.

**SAMPLE UNIFIED SCHOOL DISTRICT RESOLUTION NO. XXXX  
RESOLUTION COMMITTING TO MEET FINANCIAL OBLIGATIONS AND  
MAINTAINING FISCAL SOLVENCY**

WHEREAS, the Governing Board has a fiduciary duty to meet its financial obligations in the current fiscal year and two subsequent fiscal years pursuant to Education Code 42127; and

WHEREAS, significant fiscal challenges exist for the forecast periods 2021-22 and 2022-23; and

WHEREAS, multiyear planning factors are limited at this time and may not provide adequate information on which to build a dependable multiple year financial projection for detailed revenues, expenditures and fund balance computations for 2021-22 and 2022-23; and

WHEREAS, current planning factors result in deficit spending that will require corrective actions to maintain the fiscal stability of the district.

NOW, THEREFORE, the Governing Board of the \_\_\_\_\_ School District resolves as follows:

1. A safe and high quality education program will be maintained for all students.
2. The district will make timely updates to its multiyear financial projections based on generally accepted planning factors for California K-12 public education.
3. If the fiscal condition of the district further deteriorates, the district will implement all necessary budget adjustments (revenue increases, expenditure reductions, reserve allocations) for 2021-22 and 2022-23 to meet financial obligations and maintain fiscal solvency.
4. The district is committed to fulfilling its obligations to respond to, provide requested information, and take the necessary actions to resolve questions from the \_\_\_\_\_ County Office of Education regarding the district’s financial operations.

PASSED AND ADOPTED by the Governing Board on \_\_\_\_\_ by the following vote:

AYES: \_\_\_\_\_

NOES: \_\_\_\_\_

ABSENT: \_\_\_\_\_

STATE OF CALIFORNIA COUNTY OF \_\_\_\_\_

I, \_\_\_\_\_ Clerk/Secretary of the Governing Board, do hereby certify that the foregoing is a full, true, and correct copy of a resolution duly passed and adopted by said Board at a regularly called and conducted meeting held on said date.

\_\_\_\_\_  
Clerk/Secretary of the Governing Board