# CBO/MENTOR PROGRAM

School Fiscal Issues

**STAYING OUT OF TROUBLE**

AB1200 from an Agency Perspective

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Presented By

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# OVERVIEW

- AB 1200—Oversight and Responsibility
- What is Financially Troubled?
- 13 Most Common Mistakes Made by Troubled Districts
- What Happens When…..You Get Into Trouble, and…
- How the Heck do You Get Out?

# AB 1200
# and
# Oversight Responsibilities

# AB 1200 and Oversight Responsibilities

- AB 1200 (EC 42127) sets financial standards for school districts and includes enough "teeth" to assure adequate oversight…maybe
- AB 1200 was enacted in order to help school districts avoid insolvency, it is a progressive law and it does work!
- AB 1200 created the Fiscal Crisis and Management Assistance Team (FCMAT)
- AB 1200 empowered County Offices of Education with fiscal oversight to follow a progression of interventions:
  - Initiate action if financial problems are discovered
  - Lower a self-rating from "positive" to either "qualified" or "negative"
  - Appoint a fiscal advisor, or more stringent measures

# AB 1200 and Oversight Responsibilities

- The COEs are now the “second line of defense” to protect the state from liability for school district financial problems
- AB 1200 also allows the COE to place restrictions on school boards and superintendents if the budget is rejected
- But some districts discover that problems are too big or recognized too late for the COE to help resolve
- So, AB 1200 also anticipates that the Superintendent of Public Instruction (SPI), the Legislature, and ultimately the Governor may also have to play a role
- This just in – getting a “state bailout loan” is likely to spoil your whole day!

# AB 2756 Adds New Requirements/Functions

- State Standards and Criteria are updated and expanded
- The State Board of Education will adopt professional and legal standards as a guide to good fiscal management practices
- Emergency loan provisions augmented to add a higher level of accountability and reporting
- Regional Assistance Teams are established
- Conditional budget approval added as an option for COEs
- Superintendent and CBO certification of collective bargaining agreements are now required

ref: ab 2756 (Daucher)

# Our Definition of “Financially Troubled”

# Our Definition of “Financially Troubled”

- What do we mean when we say a district is in financial trouble? A troubled district:
    - May have a history of deficit spending
    - May have qualified or negative interim reports
    - May have its budget disapproved by the County Office of Education
    - May not be able to conform to multi-year projection standards
    - May not have enough cash to meet its obligations
    - Probably has poor oversight and monitoring of its finances
- In short, it is a district that cannot meet state standards on its own

# Our Definition of “Financially Troubled”

- There are always troubled districts – normally district fortunes rise and fall in tandem with state economics but some are chronic
    - The number of qualified districts in the state increased this year
    - 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
    - The number of Negative Certification districts also increased
    - A district is negative when it is determined that it will not meet its financial obligations in the current and next fiscal year
    - The number of budget disapprovals by COEs appears to be increasing?????  Why??

# So, How Do Districts Get Into Trouble?

# Spotting Trouble—the difference between early recovery and insolvency

- The 13 Most Common Financial Mistakes Made by Districts
  - Overly optimistic estimates of state economics
  - Overly aggressive estimates of enrollment, attendance and ADA
  - Failure to document and monitor budget assumptions
  - Loss of control of staffing levels and costs
  - Underestimating “automatic” cost growth
  - Use of one-time money for ongoing expenses
  - Bad decisions at the negotiating table

# Spotting Trouble—the difference between early recovery and insolvency

- <u>The 13 Most Common Financial Mistakes Made by Districts</u>
  - Failure to consider multi-year impact of budget decisions
  - Failure to follow through on budget reductions or recovery plans
  - Inadequate budget monitoring by the superintendent and board
  - Chronic, unplanned deficit spending
  - Inadequate reserves and/or no plan to build reserves
  - Not cooperating with the COE

# Overly Optimistic Estimates of State Economics

- The January Governor's Budget proposals are just that – proposals
- Until the Legislature acts, there are no guarantees
    - Most years the Governor is in charge of the budget – especially true this year!
    - The May Revision has required major changes, but it is a proposal as well not an automatic !!!!!
- We have come to expect that the statutory COLA, as well as enrollment growth, will be funded
    - Deficits and budget cuts in the past years should have disproved that expectation—Proposition 98 guarantee is <u>still</u> in significant jeopardy
- Budgets based on optimistic projections must have a fallback position

# Overly Aggressive Estimates of Enrollment, Attendance and ADA

- Never overestimate ADA!
  - Nearly all state funding is based on ADA
  - The floor on ADA is last year's P-2 ADA
  - You need a sound basis for an estimated ADA above that level
- ADA:enrollment ratios usually change slowly
  - If you are expecting to improve attendance, prove it before you add revenue to the budget
- Enrollment can be calculated using a cohort survival model
  - But must be modified if new information is available – for example, a new housing development
  - Always do a "reality check"
- If ADA is overestimated, adding staff to serve ADA that never shows up creates an even bigger disaster

# Failure to Document Budget Assumptions

- Budget assumptions are the basic building blocks of the budget
  - Write and publicize the assumptions on which the budget is based
    - Revenue growth including COLA
    - Enrollment growth or decline
    - Benefit cost increases
    - Program augmentations
    - Post-retirement benefits
    - Fuel and utility costs
    - Costs to open or close a school
- Test and revise assumptions throughout the budget cycle (they are more often initially wrong than right!)
- Written assumptions provide linkage to the original budget

# Loss of Control of Staffing Levels and Costs

- Personnel costs represent the lion's share of the budget – 80%-90%
  - Numbers of people
  - Costs for salary schedule maintenance
  - Pay raises
  - District-paid benefits
  - All of these factors affect the budget dramatically
- Position control systems control numbers of people, assignments, and, therefore, personnel costs
- Overstaffing, intentional or unintentional, is the single most common cause of budget problems
- Staffing cost numbers are so big that the problem can get out of control quickly
- If you blow staffing costs, there is not enough money in the rest of the budget to fix it – you must address staffing

# Underestimating "Automatic" Cost Growth

- Automatic cost increases are pervasive to the budget
  - Step increases for seniority
  - Column increases for professional preparation
  - Fuel and utility cost increases (good luck here!)
  - Health benefit increases (Got Cap?)
  - Workers' Compensation insurance increases
- All of these – and more – factors lead to "uncontrollable" increases in expenditures
- COLA and growth funding increases must cover all of these increases as well as any salary schedule increases

# Use of One-time Money for Ongoing Expenses

- Don't spend one-time money on anything that eats
  - How will you feed it next year?
- One-time money should be used carefully
  - Good dollars for reserves or one-time expenditures
  - Equipment, technology upgrades, and other nonrecurring expenditures
- Withdrawals from reserves are one-time revenues – do not use them for ongoing salary or benefit increases
  - Sometimes it is appropriate to use reserves for the retroactive portion of a salary settlement

# Poor Decisions at the Negotiating Table

- The negotiations table will have a fiscal impact
- Pressure to give more than you can afford can be tremendous
  - “Giving COLA” and finding another way to pay for everything else is a lethal recipe
- Think, and negotiate, based on total compensation
  - Consider step and column, employee benefits as part of any basis for salary increases
- Language issues also cause financial problems
- The CBO needs to be at the negotiating table and should independently cost out each proposal
- Factfinding isn’t fun, but it’s better than a bad agreement
- Remember, salary increases compound both horizontally and vertically through the salary schedule

# Failure to Consider the Multi-Year Impact of Budget Decisions

- AB 1200 requires districts to consider the budget impact on the current year and two subsequent years
- Multi-year planning does not rely on a crystal ball – it is the mathematical consequences of the actions of today
- Most major budget failures can be traced to specific events and decisions
- The COE should intervene if your multi-year projections are less than positive
- We recommend you do a “sensitivity analysis” on your projections
  - What happens if COLA assumptions go up or down?
  - What if ADA changes?   Do Trend Analysis!
- Failure to look to the future may ensure that your own “future” ends

# Failure to Follow Through on Budget Decisions

- Difficult budgets require difficult decisions
  - Those decisions are hard to make and sometimes the board takes considerable public punishment for making them
  - But once those decisions have been made, they must be implemented – but often they are not!
    - Positions are not cut
    - Expenditures are not reduced
- Failure to follow through, no matter how good the excuse, requires that the board and superintendent re-address the budget
- Bad news does not get better with age – if the cuts can't be made, develop a new plan early

# Poor Budget Monitoring by the Superintendent and Board

- The budget is only a plan and is only as good as its last revision
- Tie changes to the original assumptions so the linkage is clear
- There are at least 5 required “checkpoints”
  - Budget adoption
  - The first interim
  - The second interim
  - The unaudited actuals
  - Receipt of the audited financials
- Those events represent a minimum revision level; most districts need more frequent revision
- The earlier a problem is identified, the more options to fix it

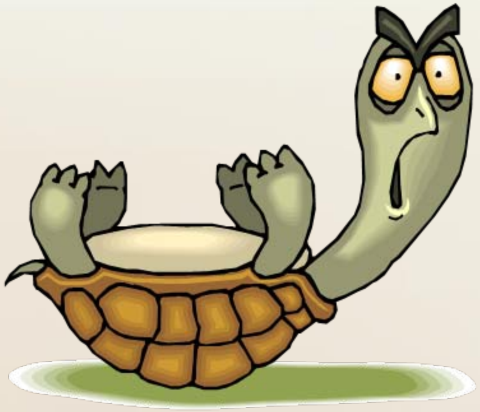
# Chronic Deficit Spending

- Deficit spending means we are spending more than we take in
- Some deficit spending may be planned when balances have been built up to allow a large one-time expenditure
- Most deficit spending is unplanned and uncontrolled
- Sooner or later you will run out of reserves
- Address the causes of deficit spending early; make the cuts while they are painful but not life-threatening for the district
- Do Trend Analysis! Deficit spending is the villain of solvency

# Inadequate Reserves

- There is no such thing as a good budget without a reasonable reserve
- Reserves are the local buffer that allows problems to be solved locally instead of turning to the COE or the state for help
- The state-recommended minimum Reserve for Economic Uncertainties is just that – a minimum number – most districts need more
- Circumstances that call for higher reserves include:
  - Declining enrollment
  - Rapid enrollment growth
  - Opening or closing schools
  - Basic Aid districts
  - Volatile economic times
- There are no circumstances that warrant lower reserves
  - Temporary shortfall should be fixed immediately

# What Happens if Your District Gets into Financial Trouble?



# What Happens If Your District Gets into Financial Trouble?

- Intervention by the County Office of Education
- The role of FCMAT
- Responsibilities of a Fiscal Advisor
- Responsibilities of a Trustee
- Responsibilities of a State Administrator
- Responsibilities of the District

# Intervention by the County Office of Education

- Intervention under the law starts with the County Superintendent
  - Level of intervention is progressive and can be tailored to the severity of the problem
  - An adverse interim report or disapproved budget puts the COE in charge to determine the level of corrective action needed
  - A fiscal expert may be appointed when a district has a qualified report.  A fiscal expert has limited authority
- Remember, the goal of the COE is to assist the district in resolving its financial problem at the lowest level of outside intervention
  - The COE can be more helpful when you are candid and get it involved early
  - A Budget Review Committee is used to adjudicate disputes between the district and the COE if they do not agree on the problem
- Try to help the COE to help you

# The Role of FCMAT www.fcmat.org

- FCMAT has a primary mission of assisting school agencies, including charter schools, in the proactive identification, prevention, and resolution of financial problems

- FCMAT staff and consultants perform studies and analyses at the request of school agencies, not just when there is trouble, but to promote effective and efficient operations

- FCMAT may be called in by the district,
  the County Superintendent,
  the Superintendent of Public Instruction, the Legislature or the Governor

# The Role of FCMAT www.fcmat.org

- FCMAT can help in
  - Determining the extent of the problem
  - Providing facts that help resolve disputes
  - Developing recovery plans
- FCMAT also advises legislators on the need for state loans
- FCMAT can be a valuable resource before you get into trouble, so ask for help (management and technical assistance)
- If you get into trouble, FCMAT will play a role in your recovery

# Responsibilities of a Fiscal Advisor

- A fiscal advisor may be assigned by the County Superintendent when it is clear a greater level of intervention is needed. A fiscal advisor is more independent and carries a greater level of authority, up to and including staying and rescinding actions of the Board

- It is the fiscal advisor's responsibility to advise the COE and attempt to avert an emergency loan

- When all else fails, the district may need a loan to resolve its financial problems

# Responsibilities of a Trustee

- What Happens if a District Receives a State Loan?
  - A bill authorizing the state loan will likely require that a trustee or a State Administrator be appointed
  - If the loan does not exceed 200% of the required reserve for economic uncertainty, a State Trustee may be appointed
  - The Trustee’s role mirrors that of the COE-appointed fiscal advisor
  - The appointment of the Trustee continues until the state loan is repaid

# Responsibilities of a State Administrator

- What Happens if a District Receives a State Loan?

  - When the state loan exceeds 200% of the required reserve, a State Administrator is assigned
  - The State Administrator functions as the Board and Superintendent rolled into one
  - The Board is advisory only until the State Administrator is replaced by a State Trustee
  - The assignment of the State Administrator is the most severe form of fiscal intervention and signals district takeover by the State Superintendent of Public Instruction

# Getting Out of Trouble

- Characteristics of districts that make a successful turnaround
  - Recognize they have a problem
  - Don’t mask the problem
  - Take advantage of financial expertise available
  - Work collaboratively with oversight agencies
  - Are part of the solution
- Characteristics of districts that require severe measures
  - Deny they have a problem
  - Resist scrutiny from outsiders
  - Don’t seek external assistance
  - Combative with oversight agencies