Indicators of Risk or Potential Insolvency

For K-12 Local Education Agencies

The Fiscal Crisis and Management Assistance Team (FCMAT) has compiled the following indicators of risk or potential insolvency based on experience with local education agencies since the inception of AB 1200 in 1991. Although some of the indicators have been on the list since first published, others have been removed or added as changes occurred, such as the evolution in funding models and changes in education and finance policy. These indicators will continue to be updated over time to ensure they remain relevant and helpful.

Each item listed indicates a lack of function, commitment, or attention to one or more critical elements of an organization's operations, which may eventually contribute to an LEA's insolvency. The existence of any one of the indicators increases risk of potential insolvency and the need for assistance from outside agencies. Lack of attention to these indicators will eventually lead to financial insolvency and loss of local control.

Identifying issues early is the key to maintaining fiscal health. Diligent multiyear planning will enable a district to better understand its financial objectives and strategies to sustain a high level of fiscal efficiency and overall solvency. A district should consider discussing the indicators regularly, and complete a Fiscal Health Risk Analysis (FHRA) annually to assess its own fiscal health risk and progress over time.

1. **Unreliable Budget Development**
   - Budget has been disapproved or conditionally approved by the county office within the last two years
   - Unreasonable and/or unclear budget assumptions
   - Reliance on prior-year rollover budget method
   - Position control data not used
   - Local Control Funding Formula (LCFF) revenue not calculated correctly
   - Reliance on carryover funds
   - One-time sources utilized for ongoing expenditures
   - Expenditures described in the LCAP not aligned with the budget
2. **Insufficient Budget Monitoring or Updates**
   - Failure to regularly update budget assumptions
   - Negative or three consecutive qualified interim report certifications
   - Downgrade of an interim certification by the county superintendent
   - "Lack of going concern" designation from the county superintendent
   - Actual revenues and expenditures inconsistent with the most current budget
   - Budget revisions not posted in the financial system or communicated to the board regularly
   - Lack of control or monitoring of total compensation as a percentage of total expenses
   - Failure to regularly reconcile balance sheet accounts in the general ledger
   - Incomplete responses to criteria and standards variances or deficiencies identified by the county office of education
   - Requisitions or purchase orders processed when the budget is insufficient
3. **Inadequate Cash Management**
   - Failure to reconcile cash accounts monthly
   - 18-month cash flow not forecast
   - Lack of short-term plan to address cash flow needs
   - Noncompliance with Education Code requirements when interfund borrowing is occurring
   - Failure to set aside repayment funds when external borrowing is occurring
   - Lack of communication to the board about the district's cash position (with a clear distinction that cash and fund balance are not the same thing)

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Indicators of Risk or Potential Insolvency (continued)

4. **Mismanaged Collective Bargaining Agreements**
   - Failure to consider long-term impact of collective bargaining agreements
   - Lack of bargaining agreements with all units for several years with no resources identified to cover potential settlements
   - Presettlement analysis not conducted thoroughly or timely
   - Settlements above the funded cost of living adjustment (COLA)
   - Lack of compliance with public disclosure requirements under Government Code Sections 3540.2, 3543.2 and 3547.5 and Education Code Section 42142
   - Board approval of collective bargaining agreement is inconsistent with superintendent's and CBO's certification

5. **Increasing and/or Unplanned Contributions and Transfers**
   - Insufficient control and monitoring of contributions and transfers
   - Lack of a board approved plan to eliminate, reduce, or control contributions/transfers
   - Transfers from the unrestricted general fund not made when needed to cover projected negative fund balances in other funds
   - Contributions/transfers to restricted programs and/or other funds not budgeted

6. **Continuing Deficit Spending**
   - Deficit spending in the current or two subsequent fiscal years
   - Not having or implementing a board-approved plan to reduce and/or eliminate deficit spending
   - Not decreasing deficit spending over the past two fiscal years

7. **Mismanaged Employee Benefits**
   - Actuarial valuation not completed in accordance with Governmental Accounting Standards Board (GASB) requirements to determine the unfunded liability for other post-employment benefits (OPEB)
   - Lack of a board adopted plan to fund health and welfare retiree benefit liabilities
   - Nonexistence or noncompliance of a policy or collectively bargained agreement to limit accrued vacation balances
   - No verification and determination of eligibility for benefits for all active and retired employees and dependents in the last five years
   - Compensated leave balances not tracked, reconciled and reported

8. **Inattention to Enrollment and Attendance Reporting**
   - Enrollment decreasing and/or unstable
   - Enrollment and average daily attendance (ADA) data not monitored and analyzed at least monthly through P2
   - Consistently inaccurate data reported through CALPADS and other state reporting
   - Enrollment projections and assumptions not based on historical data, industry-standard methods, and other reasonable considerations
   - CALPADS data not reviewed and verified by applicable sites and departments and corrected as needed before the report submission deadlines
   - Unplanned or unmonitored effects of enrollment losses to charter schools
   - Board policy to limit outgoing interdistrict transfers is nonexistent, or policy is not followed

9. **Decreasing Fund Balance and Reserve for Economic Uncertainty**
   - Failure to accurately estimate the ending fund balance
   - Failure to maintain the minimum reserve for economic uncertainty
   - If unable to maintain the minimum reserve for economic uncertainty, a board-approved plan to restore the minimum reserve for economic uncertainty does not exist
   - Projected unrestricted fund balance not stable or not increasing
   - Unrestricted fund balance does not include assigned or committed reserves above the recommended reserve level when unfunded or contingent liabilities or one-time costs exist

Indicators of Risk or Potential Insolvency (continued)

10. Ineffective Internal Controls and Fraud Prevention

- Lack of controls that limit access to the financial system
- Access and authorization controls to the financial system not reviewed and updated upon employment actions (e.g., resignations, terminations, promotions or demotions) and at least annually
- Duties in accounts payable, accounts receivable, purchasing, contracts, payroll, human resources, associated student body, and warehouse/receiving not segregated, supervised or monitored
- Beginning balances for the new fiscal year not posted and reconciled with the ending balances from the prior fiscal year
- Prior year accruals not reviewed and cleared by first interim
- Suspense accounts not reconciled regularly
- General ledger not reconciled or closed timely
- Inadequate processes and procedures in place to discourage and detect fraud

11. Breakdown in Leadership and Communication

- Uninformed decisions made because the system(s) can't provide key financial and personnel data needed
- Instability in the chief business official or superintendent positions (been with the district less than two years)
- Lack of regular communication between the superintendent and all members of the administrative cabinet
- Timely training on financial management, budget and governance not provided to site and department administrators who are responsible for budget management and decision-making
- Board policies and administrative regulations routinely ignored, not adopted, updated, implemented or communicated to staff
- Micromanagement by board members
- Systems fully or partially controlled by highly influential special interest groups

12. Lack of Multiyear Planning

- Unreasonable and/or unclear multiyear projections that are not aligned with industry standards
- Failure to explain trend analysis
- LCFF calculation not prepared with multiyear considerations
- Financial decisions made without most current multiyear projection in mind
- Detailed information not included when "other adjustments" is used with multiyear projections (line B10)

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

- Sources of non-voter-approved debt repayment unstable, unpredictable and not from the unrestricted general fund
- Downgrade of credit rating
- Out-of-date actuarial study without a plan to pay for any unfunded liabilities when self-insured
- High levels of non-voter-approved debt (such as COPs, bridge financing, BANS, RANS and others), with total annual debt service payments greater than 2% of the district's unrestricted general fund revenues

14. Lack of Position Control

- Financial and human resources systems not integrated
- Accounting for positions and costs is incomplete
- Staffing not analyzed or adjusted based on staffing ratios and enrollment
- Budget, payroll and position control not reconciled regularly
- Budget source not identified for each new position before the position is authorized by the governing board
- New positions and extra assignments posted before governing board approval
- Staffing ratios for certificated, classified and administrative positions not adopted or followed
- Lack of regular meetings between human resources, payroll and budget to discuss issues and improve processes.

Indicators of Risk or Potential Insolvency (continued)

15. Related Issues of Concern
    - Failure to produce timely and accurate financial information
    - Annual Independent Audit Report contains material apportionment or internal control findings
    - Inadequate, undocumented monitoring and oversight of authorized charter schools
    - Out-of-date long-range facilities master plan
    - Special education costs not monitored, with contribution rate above the statewide average contribution rate
    - Special education staffing ratios, class sizes and caseload sizes do not align with statutory requirements and industry standards
    - District and the county office of education have different financial systems and lack automated interface