

Avoiding The Pitfalls

(And There Are Lots Of Them These Days)

A FCMAT Perspective

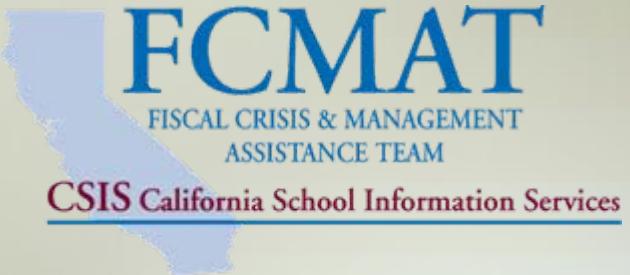
ACBO Training Institute
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Overview

- Definition of “Financially Troubled”
- How Do CC Districts Get Into Trouble?
- Current State Budget Issues
- The Economic Environment—A Primer for Planning
- How To Survive the Short and Long Term
- Attachments

What is “Financially Troubled?”

- A financially troubled district:
 - May have a history of deficit spending
 - May have CCFS 311/311Q reports that reveal fiscal issues
 - May have GF unrestricted fund balance that is trending negative regarding the percentage related to expenditures and other outgo
 - Cannot maintain a prudent, GF unrestricted fund balance of 5%
 - May not be able to conform to multiyear projection standards
 - May not have enough cash to meet its obligations
 - May have audit issues
 - Has poor communication with the Systems Office

Common Causes of Financial Problems

- Overly optimistic estimates of state economics
- Declining enrollment or unstable enrollment/FTES
- Failure to document or change budget assumptions
- Loss of control of staffing levels and costs
- Underestimating “automatic” cost growth
- Use of one-time money for ongoing expenses
- Poor decisions at the negotiating table
- Failure to consider the multiyear impact of budget decisions
- Poor budget monitoring by the CEO and Board
- Chronic deficit spending
- Inadequate reserves
- Debt issues

Enrollment and FTES

- K-12 Enrollment is on the Decline (Prop 98 Impact)
- Community Colleges serve 2.5 million Students (70% of post secondary)
- Have been predicting 1.5% annual growth through 2011-12
 - Less than 8% total from 2002-2006
- Still CA population anticipated to be 44 million in 2050
 - Population growth bodes well for CC enrollment as does a struggling economy
- That darned CAP!
- Other associated problems
 - Space and Facilities
 - Vocational Education Programs are Expensive

Loss of Control of Staffing Levels and Costs

- Personnel costs represent the lion's share of the budget – 80%-85%
 - Costs for salary schedule maintenance
 - Pay raises
 - District-paid benefits
 - OPEB
 - 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 miscalculate staffing costs, there is not enough money in the rest of the budget to fix it – you must address staffing

Poor Decisions at the Negotiating Table

- The negotiations table is a fiscal danger zone
- 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/CFO needs to be at the negotiating table and should independently cost out each proposal
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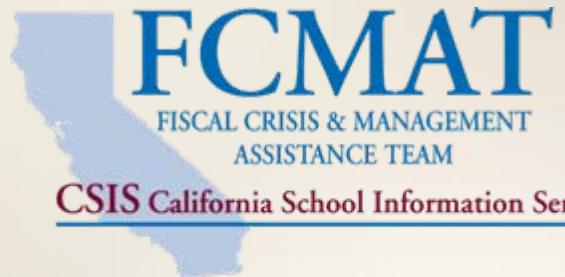
Failure to Consider the Multiyear Impact of Budget Decisions

- FS 05-05 actually 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 Systems Office should intervene if your multiyear 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 FTES assumptions change?
- Failure to look to the future may ensure that your own “future” ends early

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

What Happens if your District Gets into Financial Trouble?



CSIS California School Information Services

Monitoring and Assessment of your Fiscal Condition

- Information used to perform the assessment include at least:
 - Quarterly Financial Status Reports-CCFS-311Q
 - Annual Financial Status Report-CCFS-311
 - Annual District Audit
 - Apportionment Attendance Reports-CCFS-320
 - District response to inquiries from the Systems Office
- Remember, the System's Office's goal is to assist a district in resolving its financial problem at the lowest level of outside intervention
- The System Office can be more helpful when they get involved early.

Monitoring and Assessment of your Fiscal Condition

Primary Assessment Criteria

- General Fund analysis
- Unrestricted fund balance analysis
- Review of object codes 1000 through 7000
- Minimum Prudent Unrestricted Fund Balance = 5% (min)

Secondary Criteria

- Spending patterns
- FTES review
- Salaries and benefits review
- Other—audit findings, legal issues, timely filing of reports, etc.

Follow Up Actions if Necessary

- No Action—All Systems Go!
- Periodic Monitoring Necessary
 - Complete Checklist
 - Update 311Q
 - Create Action Plan to address concerns
 - Communicate regularly with the Systems Office
- Management Assistance Required
 - Complete Checklist
 - Submit a Comprehensive 311Q
 - Submit an Assistance Plan with the aid of FCMAT or other entity
 - Participate in Quarterly Review by CEO and CBO/CFO
 - May require the development and submission of a Recovery Plan

Follow Up Actions

- District Requires Fiscal Intervention
 - Conduct a Comprehensive Management Review of the district and its educational programs and Audit the fiscal condition
 - Direct district to amend and readopt Fiscal and Educational Plans based on the findings and recommendations of the Comprehensive Review
 - Direct outside fiscal crisis intervention from FCMAT or other specialized entity
 - Assign a Special Trustee to assume Management and Fiscal control of the district

The Role of FCMAT

- Primary mission: assisting PK-14 education agencies in identification, prevention, and resolution of financial problems
- FCMAT staff and consultants perform studies and analyses at the request of education agencies, not just when there is trouble, but to promote effective and efficient operations
- May be called in by the district, the CC Board of Governors, Legislature, or the Governor

The Role of FCMAT

- 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
- If you get into trouble, FCMAT will almost certainly play a role in your recovery

Responsibilities of the District

- Characteristics of districts that avoid Pitfalls:
 - Recognize when they have a problem
 - Don't mask the problem (bad news does not improve with age)
 - Take advantage of financial expertise available
 - Work collaboratively with oversight agencies
 - Are constantly Reassessing their Fiscal Position and Health
- 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
 - Panic

Beginning with Basic Economics

- The National Economy and Budget Collapse
- Lack of Consumer Confidence
- A Correction in the Housing Market
- Tightening of the Credit Markets
- Construction and Unemployment
- Is it a Revenue or Expense Problem?
- The Perfect Storm???

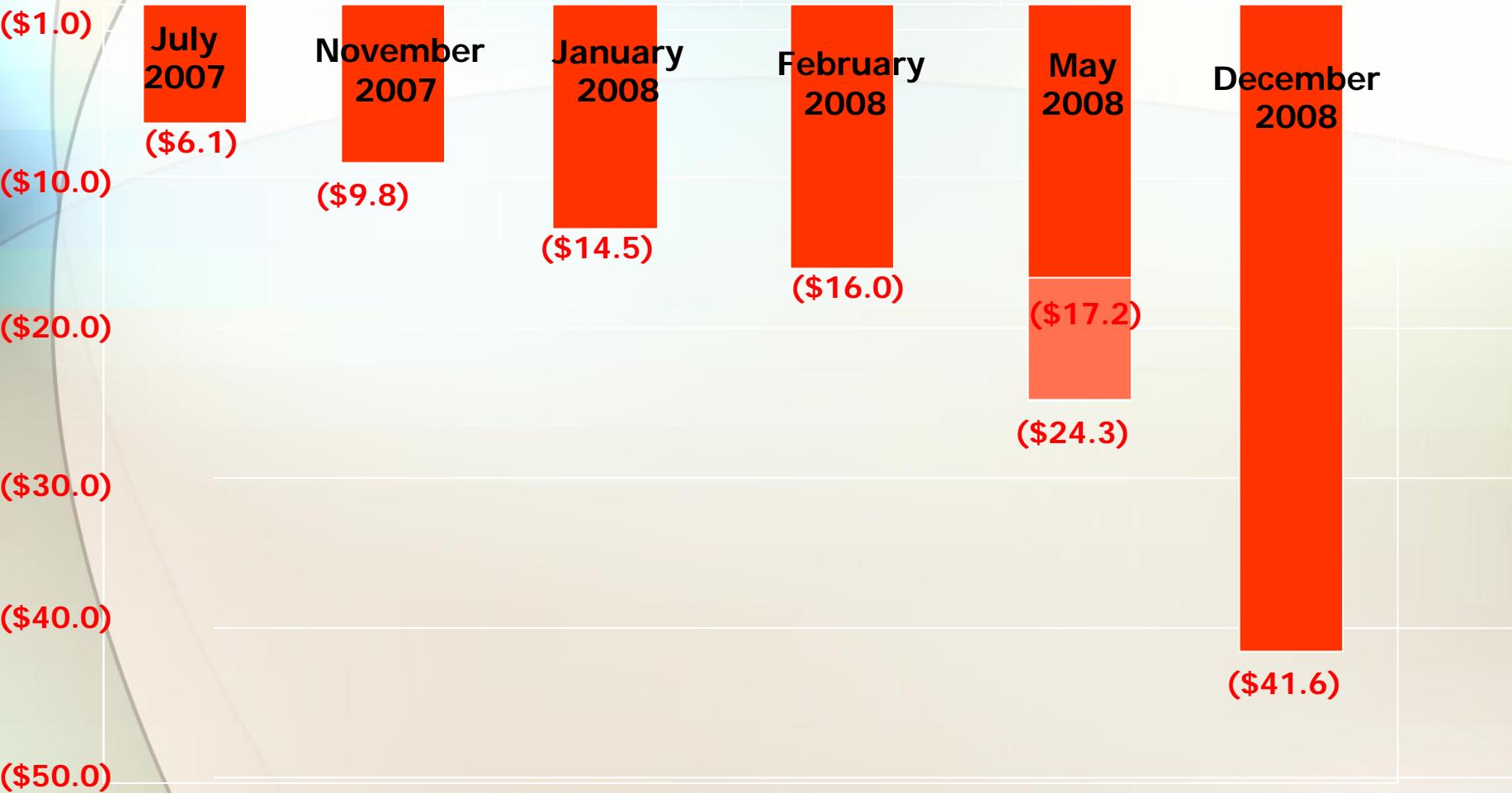
What's The Status?

- There is an economic crisis
- Our state has a structural deficit
- Unemployment is at 9+% and Growing
- Housing Continues to Correct
- The Legislature is in Emergency Session
- All of Education is going to be dramatically impacted

Inquiring Minds Want to Know

- Will there be a Depression?
- Is the Stock Market at the bottom?
- When will Recovery begin?
- What about Mid-year reductions/adjustments?
- Will there be COLAs every again?
- What's next?

State Budget Deficit Grows Despite Mid-Year Reductions



Source: Department of Finance and Legislative Analyst's Office

Governor's Budget Proposals \$41.8 Billion in Solutions

- Expenditure Reductions - \$17.4 billion (42%)
 - K-14 Education - \$7.7 billion (44% of all cuts)
- New Taxes and Fees - \$14.3 billion (34%)
- Borrowing - \$10 billion (24%)

K-14 Education Spending and the Budget Shortfall

Comparison of State General Fund Revenue and Expenditure Increases to Increases in K-14 (Prop. 98) Guarantee

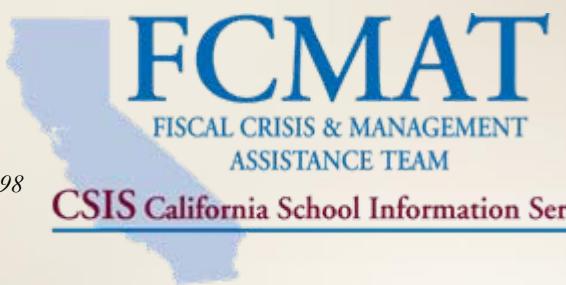
1998-99 Through 2009-10

	(Dollars in Billions)		
	1998-99 ¹	2009-10 ²	% Increase
General Fund Revenues	\$57	\$97.7	71%
K-14 (Prop. 98) Expenditures	\$35.2	\$55.9	59%
Non K-14 (General Fund) Expenditures	\$32.8	\$62.5 ³	91%

¹Legislative Analyst's Office. State spending Plan: 1998-99. October 1998, Page 4, Revenues & Expenditures; p. 26 Proposition 98

²Department of Finance. Overview of the Governor's Budget: 2009-10. January 2009 (assumed all proposed budget solutions)

³Adjusted for Local Property Tax Transfers per VLF Transfer and Triple Flip (LAO, Jan. 2009 est.)



K-14 Education Spending and the Budget Shortfall

Comparison of Major General Fund Expenditure Areas

1998-99 through 2009-10

	(Dollars in Billions)		
	<u>1998-99¹</u>	<u>2009-10²</u>	<u>% Increase</u>
K-14 (Prop. 98) Expenditures	\$35.2	\$55.9	59%
Health & Human Services	\$15.3	\$30.0	96%
Business, Transportation & Housing	\$0.4	\$2.3	475%
Corrections	\$4.4	\$9.6	119%
Resources	\$1.0	\$1.92	92%
General Fund Revenues	\$57	\$97.7	71%

¹Legislative Analyst's Office. State spending Plan: 1998-99. October 1998, Page 4, Revenues & Expenditures; p. 26 Proposition 98

²Department of Finance. Overview of the Governor's Budget: 2009-10. January 2009 (assumed all proposed budget solutions)

What Can Districts Do Now in Anticipation of an Uncertain Fiscal Environment

- Plan—Current plus Two Years +
- Review your Assumptions regarding Interest Income
- Spend Restricted Dollars First and Conserve Cash
- Stay Current With Enrollment and Staffing
- Build Reserves/Fund Balance If Possible
- Be Careful About Debt including OPEB Bonds
- Manage Cash
- Forego Big/Expensive Budget Decision Where Possible
- Don't Put All of Your Hopes In the Flexibility Basket

Remember, This Is a Multi-Year Issue!

What Can Districts Do Now in Anticipation of an Uncertain Cash Environment

- Have a system in place to analyze and monitor cash flow—all funds
- Report cash flow status and projection to the board on a regular basis
- Conserve cash when possible—all funds
- Build Reserves/Fund Balance—all funds
- Consider creating spending plans to manage available cash
- Consider options for dry period financing (borrowing)
- Don't run out!

Summary

- A CEO and CBO/CFO have legal fiduciary responsibilities
- The vast majority discharge this duty well
- FS 05-05 requires fiscal transparency and cooperation
- A District and its Board must simultaneously:
 - Review and report past budget performance
 - Monitor and revise the current year budget
 - Plan and prepare future budgets
- FCMAT is an agency designed to assist education agencies
- If a board gets into financial trouble, the System Office must step in
- The state does not “bail out” Districts from financial troubles
- A state loan comes with a state trustee

Attachments On the FCMAT Web Site

www.fcmat.org

- FCMAT Alert—Community Colleges
- FCMAT Alert—RDA Issues K-14
- Accounting Advisory: Monitoring and Assessment of Fiscal Conditions FS05-05 (California Community Colleges Systems Office)
- Sound Fiscal Management Self-Assessment Checklist

Questions?