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# Indicators of Risk or Potential Insolvency

## FOR CHARTER SCHOOLS

The Fiscal Crisis and Management Assistance Team (FCMAT) has compiled the list of indicators of risk or potential insolvency based on more than 25 years of experience with California local educational agencies (LEAs). These indicators will 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 potentially the discontinuation of the charter school.

Identifying issues early is the key to maintaining fiscal health. Diligent multiyear planning will enable a charter school to better understand its financial objectives and strategies to sustain a high level of fiscal efficiency and overall solvency. A charter school 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

- Unreasonable and/or unclear budget assumptions
- Reliance on prior-year rollover budget method
- Position control data not used
- Local Control Funding Formula revenue not calculated correctly
- Reliance on private revenues/donations
- Reliance on carryover funds
- One-time sources utilized for ongoing expenditures
- Expenditures described in the Local Control Accountability Plan 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
- Actual revenues and expenditures inconsistent with the most current budget
- Budget revisions not posted in the financial system or regularly communicated to the board
- 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 or lack of responses to authorizer pertaining to budget development
- Requisitions or purchase orders processed when the budget is insufficient

### 3. Inadequate Cash Management

- Failure to reconcile cash and investment accounts monthly
- Eighteen-month cash flow not forecast
- Lack of short-term plan to address cash flow needs
- Failure to properly account for factoring of accounts receivable(s)
- Failure to document and reconcile if intercharter borrowing or transfers are occurring
- Failure to set aside repayment funds when borrowing is occurring
- Lack of communication to the board about the charter'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 Salary and Benefit Decisions

- Failure to consider long-term impact of salary and benefit and other compensation agreements
- Lack of consideration of employee salary and benefit agreements for several years with no resources identified to cover potential adjustments
- Analysis of cost of salary of benefit agreements not conducted thoroughly or timely prior to final decision
- Total cost of salary and benefit agreements above the funded cost-of-living adjustment

## 5. Increasing and/or Unplanned Contributions

- Insufficient control and monitoring of contributions
- Lack of a board-approved plan to eliminate, reduce, or control contributions
- Contributions to restricted programs 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, if applicable, not completed 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
- Nonexistence or noncompliance of a policy 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 data not monitored and analyzed at least monthly through P-2
- Consistently inaccurate and/or untimely data reported through California Longitudinal Pupil Achievement Data System (CALPADS) and other state reporting requirements
- Enrollment projections and assumptions not based on historical data, industry-standard methods, and other reasonable considerations
- Data from the CALPADS not reviewed and verified by appropriate knowledgeable staff and corrected as needed before the report submission deadlines
- Failure to timely submit the Pupil Estimates for New or Significantly Expanding Charters, if expanding

## 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 reserves above the recommended reserve level when unfunded or contingent liabilities or one-time costs exist

## 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

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## Indicators of Risk or Potential Insolvency (continued)

- 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

- Instability in the chief business official or superintendent/CEO positions (they have been with the charter school less than two years)
- Uninformed decisions made because the system(s) cannot provide key financial and personnel data needed
- Lack of regular communication between the superintendent/CEO and all members of the executive leadership team
- Lack of governing board holding school leadership accountable
- Governing board not meeting regularly
- Agendas and minutes from board meetings are not made available to the public
- Deteriorating relationship between governing board/superintendent/CEO and authorizer
- Timely training on financial management, budget and governance not provided to administrators who are responsible for budget management and decision-making
- Board policies, administrative regulations and bylaws are 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
- Nonprofit exempt status has been revoked, denied, or suspended

### 12. Lack of Multiyear Planning

- Unreasonable and/or unclear multiyear projections that are not aligned with industry best practices
- Failure to explain trend analysis
- LCFF calculation not prepared with multiyear considerations
- Financial decisions made without most current multiyear projection in mind

### 13. Inattention to Debt and Risk Management

- Sources of debt repayment unstable, unpredictable and 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 debt (such as revenue anticipation notes [RANs], loans from the California School Finance Authority, bridge financing, selling of accounts receivable[s] and others), with total annual debt service payments greater than 2% of the charter school's unrestricted general fund revenues

### 14. Lack of Position Control

- Financial and human resources systems not integrated
- Accounting for all 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.

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## Indicators of Risk or Potential Insolvency (continued)

### 15. Related Issues of Concern

- SB 740 funding determinations for nonclassroom-based charters not submitted in a timely manner or changed to a lower funding level by CDE
- 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, if applicable
- Uncontrolled costs for special education, 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
- Failure to disclose related party transactions
- Failure to correct or address a notice to cure with a fiscal impact from the authorizing agency