

# *The* FISCAL REPORT 32 informational update

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## **What Happens When We Submit a Budget with a Qualified or Negative Certification?**

Because of the significant ongoing cuts to education funding that have occurred, many of our clients, for the first time ever, are faced with filing a First Interim report with a qualified or negative certification. We have received many questions about what the consequences are of doing so. The impact of a qualified or negative certification on an interim report is similar to that of a conditionally approved or disapproved budget when it is adopted. What follows is the statutory guidance that a county office of education (COE) and others will follow in order to assist a district that has a conditionally approved budget, a disapproved budget, a qualified certification, or a negative certification.

### **Adopted Budget**

Each district must adopt its budget for the next year by the end of June. Once the district files its adopted budget with the COE, the COE is required to do the following according to Education Code Section (E.C.) 42127:

1. Verify that the budget complies with the standards and criteria adopted by the State Board of Education, per E.C. 33127.
2. Determine whether the district will be able to meet its obligations in the current and two subsequent fiscal years.
3. Notify the district by August 15 whether the COE has approved, conditionally approved, or disapproved the budget.

Under Step 1 above, if the COE determines that the district is not in compliance with the standards and criteria, then it must document any technical corrections that need to be made and include that information in its response under Step 3.

Under Step 2, the COE is to consider not only the budget and related documentation, but also any studies, reports, evaluations, or audits conducted about the district. This is to determine whether:

- a. There is evidence that the district is showing signs of fiscal distress under the standards and criteria, or
- b. The district is found to have more than three of the 15 most common predictors of needing intervention according to the Fiscal Crisis and Management Assistance Team

(FCMAT). The complete list of predictors, with the 15 most common predictors highlighted, is available [online](#).

Under Step 3 above, if the information gathered from Steps 1 and 2 indicate that there is inadequate assurance that the district will meet its obligations for the current and subsequent two fiscal years and will resolve any problems identified in the other studies and reports, the COE is required to either conditionally approve or disapprove the district's budget. The district will be notified of this in writing, along with any recommendations for revisions to the budget, no later than August 15. Further, the COE can:

- Assign a fiscal advisor to help the district develop a budget that is in compliance with the COE's recommendations, or
- Appoint a committee to examine the COE's review and recommendations and report its findings to the COE by August 20

For any district with a conditionally approved or disapproved budget, the following timeline of major events applies (for more detail, see E.C. 42127 et seq):

September 8	District must revise its budget to incorporate: (1) any changes to revenues or expenditures since adoption of the budget and (2) the recommendations of the COE
September 22	COE must notify the Superintendent of Public Instruction (SPI) of all districts for which budgets may be disapproved
October 8	(a) COE must review the district's revised budget to determine whether it complies with the standards and criteria, implements the recommendations of the COE, and demonstrates that the district can meet its obligations for the current and subsequent two fiscal years, and then either approve or disapprove the revised budget  (b) If the budget is disapproved, COE must create a budget review committee, unless there is a duly authorized waiver of the committee  (c) COE must report to SPI all districts with disapproved budgets or budget review committee waivers
October 31	If a budget review committee is formed, it must complete its review of the district's budget and either:  (a) recommend adoption of the district's budget, or  (b) provide recommendations to the district, COE, and SPI for budget revisions to ensure that it meets the standards and criteria
November 30	If budget review committee is waived, a balanced budget is developed and adopted either by or on behalf of the district by the COE  If budget review committee is formed and provides its report, the COE must

	<p>either approve or disapprove the district's budget, depending on the budget review committee's report. If the budget is disapproved, the COE has the authority to develop and adopt a budget and financial plan that will allow the district to meet its obligations. Thereafter, the COE may also:</p> <p>(a) Cancel purchase orders, prevent the issuance of warrants, and otherwise stay or rescind any action that is inconsistent with the financial plan</p> <p>(b) Monitor and review the operation of the district</p> <p>(c) Augment district financial staff (subject to SPI approval) as necessary to ensure appropriate management of finances</p> <p>(d) Require that the district encumber all obligations, prepare cash flow analyses, prepare periodic budget revisions, and appropriately record accounts receivable and payable</p> <p>(e) Employ (subject to SPI approval) a certified public accounting firm to investigate any financial problem areas</p> <p>(f) Withhold compensation of the district's governing board members and superintendent for failure to provide financial information as requested</p> <p>The district is required to pay 75% of the costs of the foregoing provisions, and the COE pays 25%</p>
December 10	COE must report to the Department of Finance and the Legislature if any district does not have an adopted budget by November 30

### Interim Reports

Interim reports on the district's financial and budgetary status must be prepared by each school district at least two times per year: for the period ending October 31 and for the period ending January 31 (E.C. 42130 et seq). The governing board is required to approve each report within 45 days of the end of the period. Included in this process is the requirement for the governing board to certify, in writing, whether the district has the ability to meet its obligations for the current and subsequent two fiscal years. There are three possible certifications:

Positive: The district is projected to meet its obligations in all three years

Qualified: The district may not meet its obligations in the current and/or subsequent two years

Negative: The district will not meet its obligations in the current or subsequent year

If the district has certified the interim report as positive, the COE can change the certification to qualified or negative if it determines that that is the appropriate

certification. Keep in mind, though, that, for 2009-10, the COE cannot declare a qualified certification if the issue is in 2011-12 and is primarily due to the loss of federal stimulus funds (ABX4 2, Chapter 2/2009). The COE must notify the district within 30 days if the COE downgrades the district's certification. The district can then appeal the COE's action to the SPI, who has ten days to notify the district and COE of its determination.

The COE must provide a report to the State Controller's Office (SCO) and the SPI within 30 days from the time the district is required to submit the interim report of any districts for which there is a qualified or negative certification (either self-certified by the district or determined by the COE). The COE is required to include in this report the actions proposed to ensure that the district will be able to meet its obligations, based upon the following options:

Assign a fiscal expert to provide advice to the district to help resolve its financial problems (paid for by the COE).

Conduct a study of the financial and budgetary conditions of the district, including a review of internal controls. The COE may hire a certified public accounting firm, if necessary, with the approval of the SPI, in which case the district would pay 75% of the cost and the COE would pay 25%.

Require the district to prepare financial projections and cash projections as necessary for the current and subsequent fiscal years.

Require the district to encumber all obligations, prepare cash flow analyses, prepare periodic budget revisions, and appropriately record all accounts payable and receivable.

Require the district to prepare a proposal to address the conditions that resulted in the qualified or negative certification.

Withhold the compensation of the district's governing board members and the superintendent for the failure to provide requested financial information.

Assign FCMAT to review the status, policies, and practices of teacher staffing, and require the district to follow the recommendations of the team.

Furthermore, the following consequences may occur for a district that has a qualified or negative certification:

The SCO has the authority to perform an audit

The district may not issue, in that year or the subsequent fiscal year, certificates of participation (COPs), tax and revenue anticipation notes (TRANs), revenue bonds, or any other nonvoter-approved debt instruments, unless the COE approves it (see "[The Side Effects of Going Qualified](#)" in the February 29, 2008, edition of the *Fiscal Report*)

Any district that has a negative certification as of the Second Interim reporting period is required to submit what is referred to as a Third Interim report. The reporting period for this ends on April 30 and the district is required to submit the report by June 1 to the COE, the SCO, and the SPI.

If the district has a negative certification, even after the appeals process, the COE must take at least one of the following actions, and all actions that are necessary to ensure that the district meets its financial obligations:

Develop and impose a budget revision that reflects the ability of the district to meet its financial obligations in the current year

Stay or rescind any action that is inconsistent with the ability of the district to meet its obligations for the current or subsequent fiscal year

Assist the district in developing a financial plan that will enable the district to meet its future obligations

Assist the district in developing a budget for the subsequent fiscal year

Appoint a fiscal advisor, if necessary, to perform any or all of the above duties

The district must pay 75% of the costs of these actions, or any costs necessary to improve the district's financial management practices, and the COE pays 25%.

### **Conclusion**

Your COE, FCMAT, and others are ready, willing, and able to provide fiscal health assistance to your district as necessary. Our advice is: If your district's budget and multiyear projections indicate that your district should certify your budget as either qualified or negative, it is best to self-certify up front. While having a qualified or negative certification does add workload to both your district and the COE because of the additional reporting and monitoring activities, self-certifying will expedite the process of getting the assistance and interventions that your district needs. Our experience has been that these agencies are most effective when the district is willing to help itself and raises the flag early enough to prevent a disaster. The interventions can be designed to meet the district's unique situation. If your district is in this situation, be sure to accept and implement the advice and recommendations that these experts provide. The bottom line is: You don't need to do this alone.

—*Sheila G. Vickers*

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