



# Bureau Brief

## Memorandum

TO : Members of the House and Senate Committees on Education  
 FROM: Policy Analysis and Research Section, Bureau of Legislative Research  
 DATE : August 11, 2015  
 SUBJECT : **Fiscal Distress**  
 PROJECT # 16-001-11

**Fiscal Distress** is the designation used to identify and correct school districts that are struggling to maintain fiscal stability. Of the state's three district distress classifications, fiscal distress is the most frequently used. (The other distress programs are academic and facilities distress.) Under state statute, the Arkansas Department of Education (ADE) is responsible for identifying districts in fiscal distress. The State Board of Education (SBOE) has the authority to approve or deny the designation as well as authorize ADE to take corrective actions or sanctions against the school district.

### Designation

Although ADE has administered a fiscal distress program since the mid-1990s, it was established in statute by Act 1467 of 2003. The law allows ADE to identify districts in fiscal distress if they demonstrate a declining balance, if they commit an act or violation that jeopardizes the district's fiscal integrity, or for any other fiscal condition of a school district that can have a detrimental impact on the district's ability to provide educational services. Such fiscal conditions may include:

- Failure to maintain school facilities, provide timely and accurate financial reports to specific state agencies, meet minimum teacher salaries, comply with state purchasing or bid agreements, audit requirements, or any provision of Arkansas Code
- Violation of local, state, or federal health, safety, or construction codes
- Default on any unpaid debt
- Material discrepancy between budgeted and actual expenditures
- Insufficient funds to cover payroll, salary, employment benefits, or legal tax obligations

During a given year schools are able to move into, and out of, the fiscal distress designation. Since 1996, there have been a total of 71 school districts classified in fiscal distress. After the passage of Act 1467 in 2003, there have been 60 school districts formally classified in fiscal distress. To date, there has never been a charter school in fiscal distress. Of these 60 districts, 44 have been in fiscal distress only once (73%), while the remaining 27% have been in fiscal distress one or more times. As of June 2015, there were eight school districts in fiscal distress. These include:

Guy-Perkins	Hector	Helena-W. Helena	Hughes
Lee County	Maynard	Pulaski County Special	Yellville-Summit

Four of these school districts have been identified in fiscal distress at least one additional time in the previous five years. These include:

Helena-W. Helena	Hughes	Pulaski County Special	Yellville-Summit
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### BUREAU OF LEGISLATIVE RESEARCH

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According to ADE, the majority of school districts in fiscal distress are initially reviewed due to declining fund balances. However, ADE notes a declining fund balance alone is not sufficient to result in a fiscal distress classification; the circumstances that result in being labeled in fiscal distress are unique to each school district. For instance, although only seven school districts were in fiscal distress for the 2013/14<sup>1</sup> school year, 45 other districts posted a decline in Net Legal fund balances from the previous year. The Net Legal balance is defined in APSCN as the total of the fund balances of the Teacher Salary Fund, the Operating Fund, and the Debt Service Fund less the Categorical fund balances and the escrow balance of Qualified Zone Academy Bonds (QZAB).<sup>2</sup> Another 45 school districts posted a Net Legal fund balance decline for the previous two years, while several of the districts in fiscal distress in 2014 showed increases in their Net Legal fund balances.

<b>% Change in Net Legal Balance from Prior Year for Districts in Fiscal Distress 2013-2014</b>					
	<b>Date Classified in FD</b>	<b>2010- 2011</b>	<b>2011- 2012</b>	<b>2012- 2013</b>	<b>2013- 2014</b>
Hector	05/08/2014	0.34%	6.41%	-40.44%	-23.54%
Helena-W. Helena	09/13/2010	98.99%	47.71%	29.05%	-7.75%
Hughes	04/08/2013	60.37%	-25.72%	-26.87%	4.06%
Lee County	05/08/2014	-20.74%	50.77%	-90.98%	53.22%
Mineral Springs	12/10/2012	4.86%	-34.62%	-7.23%	504.02%
Pulaski Co. Special	06/20/2011	-68.27%	445.57%	25.79%	-0.37%
Western Yell Co.	04/09/2012	-37.70%	-79.57%	181.91%	20.75%

Other potential factors that may lead a district into fiscal distress include, but are not limited to, late or missed debt payments, interest or penalties charged to the district on bonds, state or federal audit findings, declining unrestricted balances, and late fees assessed against a district. For instance, a declining fund balance in conjunction with the inability to meet district financial obligations and audit exception findings led the Hughes School District into a fiscal distress classification. Not only did the 2009 audit findings for the district note that its expenditures exceeded its revenue by \$42,255 but the district continued to reflect this pattern of overspending in Title I funds through 2014. Multiple audits also note that the district failed to hire the appropriate staff with regards to accounting and continued to hold too much in long term debt.<sup>3</sup> The confluence of these circumstances led to the classification of Hughes School District in fiscal distress as of April 8, 2013. The district remained in fiscal distress until its consolidation with the West Memphis School District in 2015<sup>4</sup>. Upon consolidation, ADE reports that the fiscal distress classification will be cleared.

There are no universal identifying characteristics specific to districts classified in fiscal distress. School districts in fiscal distress vary in both size and locale<sup>5</sup>. They also vary in the number of English Language Learners (ELL) enrolled and in the number of students with individualized educational programs (IEP). The percentage of students eligible for free and reduced lunch also varies across districts and across time.

<sup>1</sup> The fiscal data for school year 2013/14 is the most recent available data for analysis.

<sup>2</sup> QZAB is a federal program begun in 1998. The program provides LEAs with a federal tax credit in lieu of a cash interest payment on bonds used to finance renovation and repair projects within a school district. The intention is to lessen the burden on school districts undertaking school renovation projects (<http://www.qzab.org/what-is-qzab/faq/>).

<sup>3</sup> Please see the Hughes Audit Report.

<sup>4</sup> This consolidation is not the result of the school district's fiscal distress classification. It is the result of insufficient enrollment pursuant to A.C.A. § 6-13-1601-1603.

<sup>5</sup> These locale designations are taken from the National Center on Education Statistics (NCES), Common Core of Data (CCD), 2015.

Characteristics of Districts in Fiscal Distress, 2014-2015					
District	Total Enrollment	Locale	%ELL	%IEP	%NSL
Guy-Perkins	408	Rural: Distant	0.25%	18.63%	57.60%
Hector	577	Rural: Remote	1.04%	11.96%	72.79%
Helena/West Helena	1,586	Town: Remote	0.00%	10.15%	96.47%
Hughes	318	Rural: Distant	0.00%	17.61%	83.96%
Lee County	828	Town: Remote	0.12%	15.36%	90.70%
Maynard	445	Rural: Remote	0.00%	14.83%	73.26%
Pulaski County Special	16,592	Suburb: Large	2.87%	13.57%	57.30%
Yellville-Summit	694	Rural: Remote	0.14%	14.41%	87.90%

### Early Warning System

In 2009, the General Assembly passed Act 798, which required ADE to observe districts for earlier signs of fiscal problems and notify districts with two or more nonmaterial violations in one year. According to ADE rules, a nonmaterial violation is something that does not directly jeopardize the fiscal integrity of a school district but has the potential to put the school district in fiscal distress. According to ADE, the most common nonmaterial violations are audit exceptions and declining balances. To help identify potential problems, an early intervention checklist is provided to school districts by ADE. A copy of this form may be found in the appendix. This tool may help districts identify issues that could lead to an early intervention classification if left unaddressed. Districts may request support from ADE to help deal with any problems uncovered as a result of filling out this questionnaire. Although districts are not required to complete these checklists in statute, all districts do submit them to ADE for inspection. As with fiscal distress, a district may move into, or out of, the early intervention designation in any given school year, and the circumstances surrounding this designation are unique to each district.

As of June 2015, there were 10 districts in early warning. These include:

Augusta	Dollarway	Forrest City	Hazen	Lead Hill
Mansfield	Mountain Pine	Pine Bluff	Searcy County	Van Buren

Since 2009, there have been 23 districts in early warning. Of these, only 2 districts (8.7%) have been classified in early warning more than once, and only 5 districts (22%) have gone on to be classified in fiscal distress.

### Corrective Actions and Sanctions

A district that has been designated in fiscal distress must:

- File an improvement plan with ADE that includes specific ways to correct fiscal deficiencies;
- Allow on-site technical evaluations and other assistance conducted by members of the ADE Fiscal Services and Support Unit
- Adhere to recommendations from ADE to improve staffing and fiscal policy practices; and
- Report the reason for the fiscal distress to the newspaper

Districts in fiscal distress are also prohibited from incurring any additional debt without written permission from ADE.

State statute requires ADE to monitor and provide a written report every six months on the status of each school district in fiscal distress. State law also gives ADE authority to take additional measures against the school district, including:

- Removing and replacing the superintendent;
- Suspending or removing the local school board;
- Requiring fiscal training for the district staff or local board;
- Petitioning to the SBOE to annex, consolidate, or reconstitute the district; and
- Imposing additional reporting requirements on the district.

### **Removal**

To be removed from fiscal distress, a school district must demonstrate that all causes of fiscal distress have been corrected. In 2013, the General Assembly passed Act 600, which extended the time districts can remain in fiscal distress from two consecutive years to five. If a school district is not removed from fiscal distress within five years, the SBOE is required to annex, consolidate, or reconstitute the district. If the district is unable to be removed from fiscal distress due to conditions beyond its control, the law allows the SBOE to grant additional time. To date, no district has consolidated with another pursuant to A.C.A. § 6-20-1908, which states that,

The state board shall consolidate, annex, or reconstitute any school that fails to remove itself from the classification of a school district in fiscal distress within five (5) consecutive school years of classification of fiscal distress status...

Currently, the Helena-West Helena school district is the closest district to the five-year mark in fiscal distress. It was placed in fiscal distress on September 13, 2010. However, ADE is interpreting the statute to mean that the district won't be at the five-year mark until the end of the 2015/16 school year.

### **Conclusion**

The fiscal distress designation is the most often used of the three distress categorizations for school districts, established in law by Act 1467 of 2003. Districts are able to move into, and out of, fiscal distress at any time. The majority of school districts in either fiscal distress or early warning move out of these categorizations without returning. There are no universal characteristics that may help identify school districts that are more likely to be in early warning or to enter fiscal distress. Once a district is in fiscal distress, it must submit an improvement plan to ADE, allow on-site technical evaluations, adhere to any ADE recommendations made about fiscal distress, and publish its designation in a local newspaper. If a district remains in fiscal distress for five years, it must be consolidated, annexed or reconstituted, pursuant to A.C.A. § 6-20-1908. To date, no district has been consolidated for this reason although the Helena-West Helena school district will reach the five year mark at the end of the 2015/16 school year.

**Arkansas Department of Education  
Fiscal Distress Early Intervention Checklist**

**Checklist may be used as a self-reporting document**

**For the 2014-2015 school year, has the district experienced any of the following?**

1. Paid penalties, interest, or late fees on tax deposits and/or vendors within the past year?

**Yes \_\_\_\_\_ No \_\_\_\_\_**

2. Addressed and corrected all audit findings from the most recent audit?

**Yes \_\_\_\_\_ No \_\_\_\_\_**

3. Received a cash flow loan or entered into a Line of Credit agreement in the past two years?

**Yes \_\_\_\_\_ No \_\_\_\_\_**

4. A declining balance that could threaten the fiscal integrity of the school district?

**Yes \_\_\_\_\_ No \_\_\_\_\_**

5. Capital outlay expenditures paid from the district's balance?

**Yes \_\_\_\_\_ No \_\_\_\_\_**

**Any act or violation determined to jeopardize the fiscal integrity of a school district, including, but not limited to:**

6. Failure to properly maintain school facilities;

**Yes \_\_\_\_\_ No \_\_\_\_\_**

7. Violation of local, state, or federal fire, health, or safety code provisions or law;

**Yes \_\_\_\_\_ No \_\_\_\_\_**

8. Violation of local, state, or federal construction code provisions or law;

**Yes \_\_\_\_\_ No \_\_\_\_\_**

9. State or federal audit exceptions or violations;

**Yes \_\_\_\_\_ No \_\_\_\_\_**

10. Failure to provide timely and accurate legally required financial reports to the department, the Division of Legislative Audit, the General Assembly, or the Internal Revenue Service; **Yes No**\_\_

11. Insufficient funds to cover payroll, salary, employment benefits, or legal tax obligations;

**Yes \_\_\_\_\_ No \_\_\_\_\_**

- 12. Failure to meet legally binding minimum teacher salary schedule obligations;  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 13. Failure to comply with state law governing purchasing or bid requirements;  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 14. Default on any school district debt obligation;  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 15. Material discrepancies between budgeted and actual school district expenditures;  
(such as variance of unrestricted fund balance 2014-2015 budget to 2014-2015 actual)  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 16. Failure to comply with audit requirements; or  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 17. Failure to comply with any provision of the Arkansas Code that specifically places a school district in fiscal distress based on non-compliance.  
**Yes** \_\_\_\_\_ **No** \_\_\_\_\_
- 18. What is the average number of days between the receipt of the bank statements and reconciliation with APSCN reports?  
\_\_\_\_\_ **Days**
- 19. Any other fiscal condition of a school district deemed to have a detrimental negative impact on the continuation of educational services by that school district. **Yes**\_ **No**\_\_\_\_\_
- 20. Has the school district experienced two (2) or more indicators of fiscal distress in one (1) school year that the superintendent deems to be at a nonmaterial level, but that without intervention could place the district in fiscal distress?  
**Yes**\_\_\_\_\_ **No**\_\_\_\_\_

\_\_\_\_\_  
School District

\_\_\_\_\_  
Superintendent Signature

\_\_\_\_\_  
Date

Please return to:  
Arkansas Department of Education  
Fiscal Services and Support  
Attention – Cherry Norris  
Four Capitol Mall, Rm.  
105-C Little Rock, AR 2201  
Fiscal Services and Support