

# FISCAL WATCH, CAUTION, OR EMERGENCY?:

## CHALLENGING THE FISCAL PRACTICES ACT

SCSBA Annual Conference

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February 17, 2024

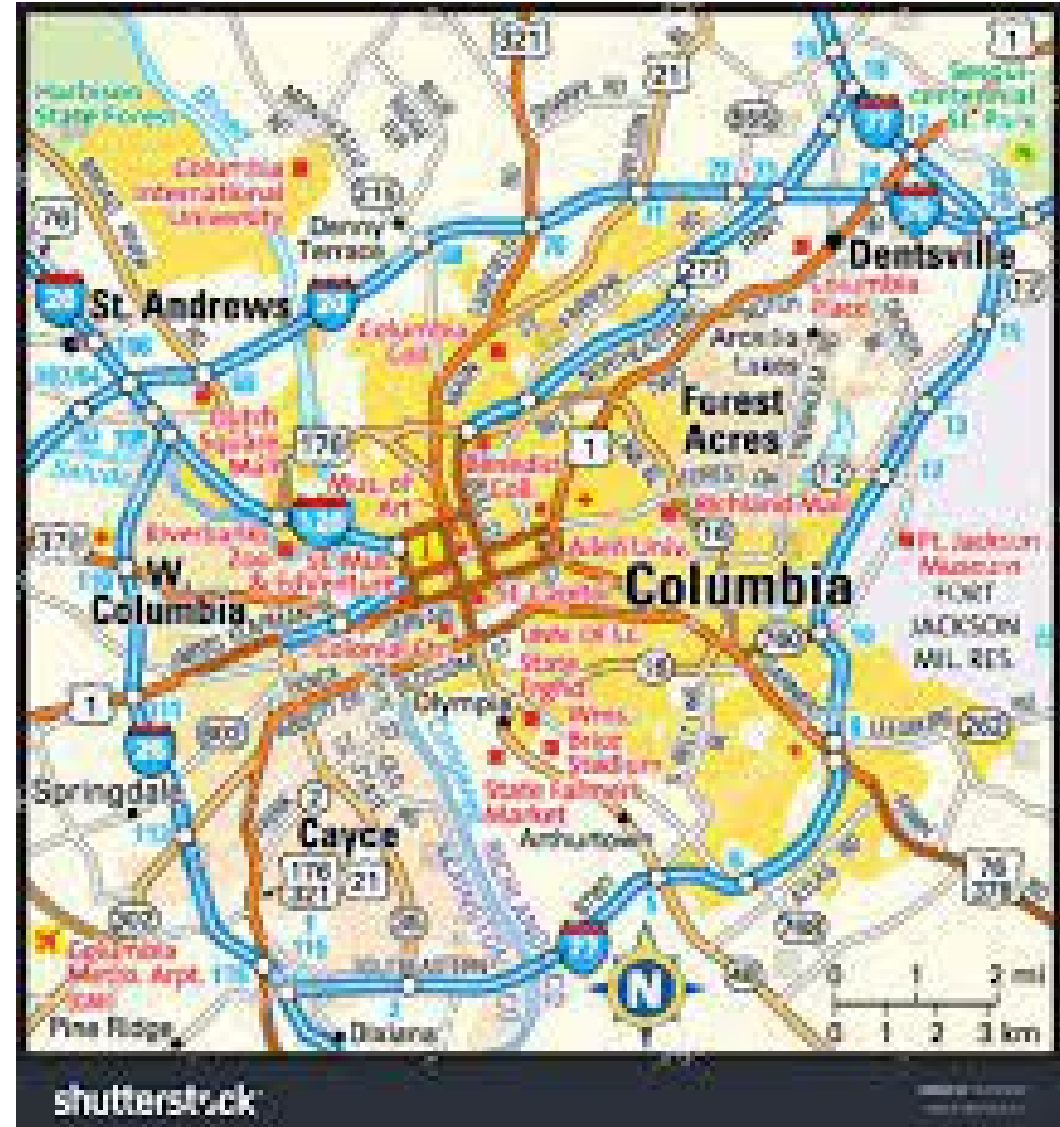
Alex Sherard



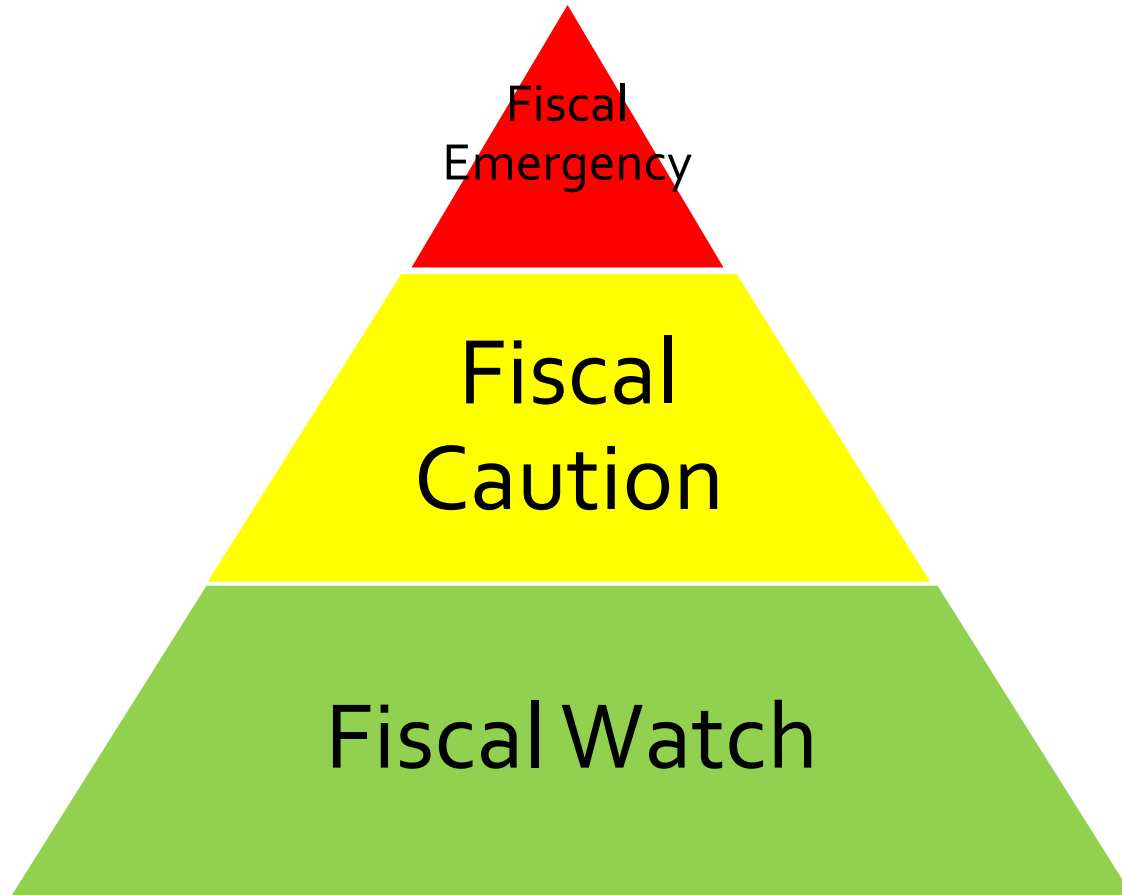
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# Roadmap

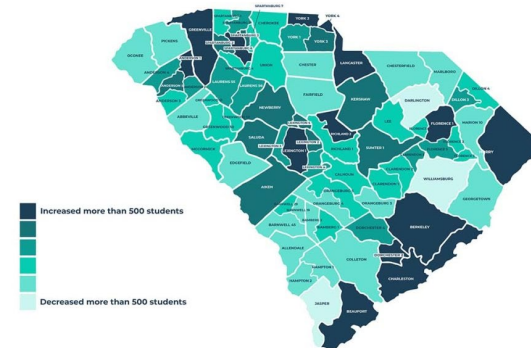
1. Overview and Background
2. Nuts and Bolts
3. Saving your District from a Declaration
4. Post Declaration Options



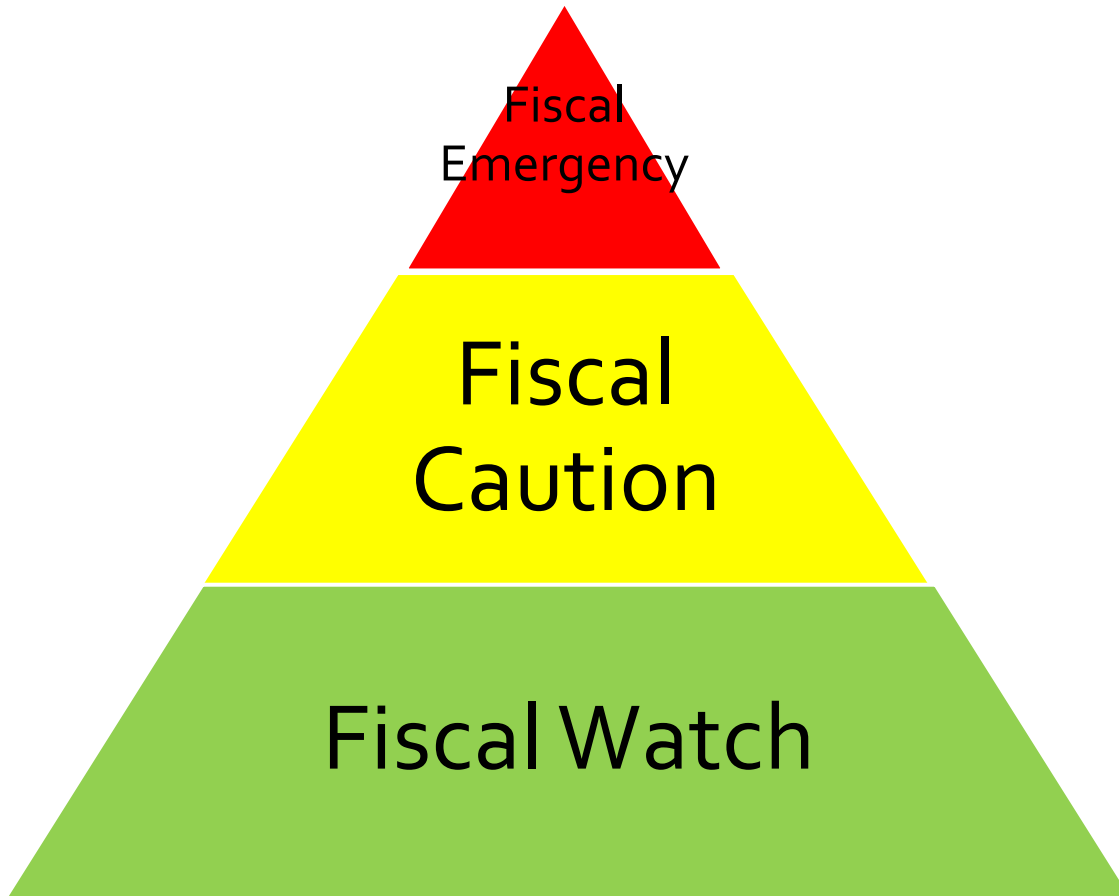
# Overview



SC SCHOOL DISTRICT NET CHANGE: FY 2012 TO FY 2017



# Overview



- Fiscal Emergency, the most severe level of concern
- Fiscal Caution, an intermediate level of concern
- Fiscal Emergency, the most severe level of concern.

# Background

- On May 9, 2017, Governor McMaster approved the Act 23, which directs the South Carolina Department of Education (SCDE) to develop and adopt a statewide program on fiscal practices and budgetary conditions.
- The SCDE convened a task force of district superintendents, financial officers, school district auditors, and staff from the state auditor to develop the statewide program. The task force was representative of districts in terms of size and geographic area of the state.
- The State Board of Education (SBE) is directed to promulgate regulations on the statute. Section 59-20-90(B). (\*\***MORE ON THIS LATER**\*\*)
- Section 59-20-90 applies to all South Carolina school districts, including the South Carolina Public Charter School District
- Governor's School for Science and Math
- Governor's School for Arts and Humanities
- DOC
- DJJ
- S.C. School for the Deaf and Blind
- Any institution of higher education that registers to become a charter sponsor

# Making the Political → Legal

- Centralized Financial Oversight
- More reasons for the SCDE to be involved on the local level
- Duties as an elected official
- Audits are presented to Board annually and available to the public
- At the mercy of the auditors
- Statute is short but Complex
- Filled with “catch-alls”
- Legal v. financial v. political
- Developed before the State Inspector General statute

# Basis for Fiscal Watch

## *Section 59-20-90(C)(1)*

- The Superintendent ***shall*** declare a fiscal watch.
  - (i) upon review of the district's annual audit, **the department determines financial practices occurring outside of acceptable accounting standards exist;**
  - (ii) the district submits an annual audit **more than sixty days** after the December first deadline provided in Section 59-17-100;
  - (iii) there is any type of ongoing, **related investigation by any state or federal law enforcement agency or any other investigatory agency of the State;**
  - (iv) an outside, independent auditing firm declares that a school district's financial records are **unauditable;** or
  - (v) the department identifies significant deficiencies, material weaknesses, direct and material legal noncompliance, or management letter comments which, in the opinion of the department, the aggregate effect of the reported issues **has, or could have**, a significant effect on the financial condition of the district.

# Process for Fiscal Watch

## *Section 59-20-90(C)(1)*



*\*Must include Steps the District can take to AVOID Fiscal Watch*



# Basis for Fiscal Caution

- The State Superintendent *shall* declare fiscal caution if:
  - (a) upon review of the district's annual audit, the department determines financial practices **occurring that are outside of acceptable accounting standards exist**;
  - (b) a district submits an annual audit **more than sixty days** after the December first deadline as provided in Section 59-17-100;
  - (c) the department reviews a district's annual audit and determines the district is not maintaining the mandatory minimum of **one month of general fund operating expenditures** in its general reserve fund or has not made progress in increasing the general reserve fund balance in accordance with department guidelines to meet at least one month of general fund operating expenditures within the previous two completed fiscal years;

# Basis for Fiscal Caution

- (d) an outside, independent auditing firm declares that a school district's financial records are unauditible;
  - (e) the department identifies significant deficiencies, material weaknesses, direct and material legal noncompliance or management letter comments which, in the opinion of the department, the aggregate effect of the reported issues has a significant effect on the financial condition of the district; or
  - (f) there is an ongoing investigation being conducted **by any federal or state agency, law enforcement or otherwise**, related to the district's finances or local board of trustees.
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- The State Superintendent shall declare a school district to be in a state of fiscal caution if the department discovers any other fiscal practices or conditions **that could lead to a declaration of fiscal emergency through the examination of a school district's past two years' audits.**

# Process for Fiscal Caution



*\*Not Required to include Steps the District can take to AVOID Fiscal Watch; Only ten (10) days required; Less chance to make improvements before issuing declaration.*

# Basis for Fiscal Emergency

## Section 59-20-90(E)

- The State Superintendent is required to declare a fiscal emergency in five situations.
- (1) Failure to submit an acceptable fiscal caution recovery plan.
  - a district under fiscal caution fails to submit an acceptable recovery plan within one hundred twenty days or fails to submit an updated recovery plan when required;
- (2) Failure to comply with a fiscal caution recovery plan.
- (3) Risk of debt default.
  - a district is at risk of defaulting on any type of debt (tax anticipation notes, general obligation bonds
- (4) Three fiscal years of fiscal watch or caution.
  - a district has previously been under fiscal watch, fiscal caution, or any combination of fiscal watch and fiscal caution for three fiscal years collectively, **regardless of whether these three years are continuous**; or
- (5) Necessary to correct fiscal problems.
  - she determines that a declaration of fiscal emergency is necessary to correct the district's fiscal problems and to prevent further fiscal decline. The State Superintendent may recommend taking over the district's financial operations.

# Consequences for Fiscal Emergency

## Section 59-20-90(E)(7)

- The State Superintendent may recommend taking over the district's financial operations.
- If the State Superintendent finds a district has not made reasonable proposals or taken action to correct the practices or conditions that led to the declaration, the Superintendent may make a recommendation to the State Board of Education that the department take over financial operations of the district for the fiscal year in which a fiscal emergency is declared as part of the technical assistance offered to the district.
- Upon approval of the recommendation ***by the State Board of Education***, the department may maintain financial operations until the district is released from a fiscal emergency.

# Issues with the FPA

- Pre-Declaration Issues
- Post Declaration Issues
- “Promulgate Regulations”
  - It’s been nearly 7 years with no regulations by the State Board!
- Release from Fiscal Declaration?
  - Statute is silent
- Continuity of Issues
  - Do same rules apply?
  - Examples
- State Bureaucracy v. Local Control
- Expense Related to Appeal
- No repercussions for wrong/bad decisions
- Little Transparency
- Vague Statutory Mandate

# Notice of Declaration or Declaration Received

- The Board Chair and Superintendent will be on all communications.
- If you are the Board Chair, you should communicate this to your fellow Board Members. (Remember FOIA!)
- Consult with your Superintendent
- Assemble your team to prepare your defense or response
- Team?
  - Superintendent
  - CFO
  - Auditors
  - Financial Staff
  - Lawyer

# What's Next? . . . It Depends.

- Fiscal Watch & Fiscal Caution
  - Is this a Notice of Declaration? Or Declaration?
  - Has the SCDE “checked all the boxes” on their end?
  - Does the Prior Written Notice contain everything the statute requires?
    - Reason for Declaration
    - Steps to avoid declaration
  - Proposal to explain or avoid declaration
    - Due within ten (10) days before declaration
- Fiscal Emergency
  - Likely not the first time the Board should be aware of this possibility
  - Triage
  - In depth plan to fix the problem
  - Attempt to get as much technical assistance and guidance from SCDE
  - Source the issue
  - Internal and External plans for recovery



# Post Declaration: Recovery Plan

- Fiscal Watch.
  - The district board must submit a financial recovery plan to the SCDE within sixty days. The State Superintendent then has thirty days from receipt to evaluate the plan, and either accept it or reject it with recommended modifications.
- Fiscal Caution.
  - After the declaration, the district has sixty days to provide a written proposal to discontinue or correct the conditions that led declaration of fiscal caution. At the district's request, the SCDE may extend that deadline one time for an additional thirty days only.
- Fiscal Emergency.
  - The district has sixty days to provide a written proposal to discontinue or correct the conditions that led to declaration of fiscal emergency. At the district's request, the SCDE may extend that deadline one time for an additional thirty days only.

# Appealing a Declaration: Legal Counsel

## Fiscal Watch, Caution, and Emergency

- The district board may appeal to the SBE within ***ten days*** of when a fiscal watch is declared.
- The district must continue working with the SCDE pending the appeal.
- The SBE must hold a hearing on the appeal within thirty days after the filing of the appeal.



# Appeal to the State Board

- <https://ed.sc.gov/state-board/state-board-of-education/>
- 16 Members (one from each circuit) (<https://ed.sc.gov/state-board/state-board-of-education/about-state-board/state-board-members-information-and-biographies/>)
- One At-Large Members
- Political Appointees--Mostly Educators
- Majority Needed to Overturn
- State Superintendent's Counsel represents the State Superintendent of Education
- "Arbitrary and Capricious"

# Uncharted Territory

- What happens if the District loses an appeal and wants to continue?
  - Appeal to the Administrative Law Court
  - Appeal to the Court of Appeals
  - Appeal to the Supreme Court
- Issues:
  - Timing
  - Expense
  - Politics
  - Courts do not like to overturn agency rulings unless its “arbitrary and capricious”
  - State Superintendent of Education typically sits on the State Board (non-voting)

# Wrap UP

- ✓ Communication is Key
- ✓ Be proactive
- ✓ Consult with Counsel at the first sign of Fiscal declaration. . . Before its too late.
- ✓ CFO should be an integral part of the process
  - ✓ Outside consultant
- ✓ Engage your auditors
- ✓ Check behind the SCDE
- ✓ Develop a Plan for Recovery and follow through

# QUESTIONS?

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