Chapter 19
Financial Accountability

Systems of Financial Accountability

Texas Education Code (TEC) §§39.082, Development and Implementation, 39.0821, Comptroller Review of Resource Allocation Practices, 39.0822, Financial Solvency Review Required, 39.0823, Projected Deficit, 39.083, Reporting, and 39.084, Posting of Adopted Budget, require the agency to develop and implement systems to hold independent school districts and open-enrollment charter schools accountable for their financial and management performance. These sections of statute require the agency to implement a financial accountability rating system, develop a review process to anticipate the future financial solvency of each school district, and oversee district planning efforts in response to a projected deficit. Additionally, TEC §39.0821 requires the comptroller to identify school districts and campuses that use resource allocation practices that contribute to high academic achievement and cost-effective operations, and TEC §39.084 requires school districts to post on the district's website a copy of the district's adopted budget and maintain the posting on the website until the third anniversary of the date the budget was adopted.

Historical Background

During the 77th Texas Legislature, 2001, legislation was passed that added new school district financial accountability requirements under TEC Chapter 39, Public School System Accountability, Subchapter I, Financial Accountability. The addition addressed the requirement of the agency, with the consultation of the comptroller's office, to develop and implement a financial accountability rating system for school districts in the state. In response, the agency developed the Financial Integrity Rating System of Texas (FIRST or School FIRST) and issued ratings to independent school districts for the first time in 2003 for the 2001–2002 fiscal year. Specifically, the agency adopted rules at 19 Texas Administrative Code (TAC) Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, to establish FIRST in order to ensure that school districts are held accountable for the quality of their financial management practices and achieve improved performance in the management of their financial resources. This initial rule adoption was effective on October 20, 2002. Subsequent amendments to School FIRST have been made in response to statutory and regulatory changes, and FIRST ratings have continued to be issued annually to school districts. The most recent changes to the state financial accountability system have been made in response to updated requirements as reflected in House Bill (HB) 3.

Impact of House Bill 3 on Systems of Financial Accountability

HB 3 renumbered and revised sections of the statute that describe the state's system of financial accountability for school districts and charter schools. Specifically, the former Chapter 39, Subchapter I, Financial Accountability, was revised and relocated to Chapter 39, Subchapter D. Additionally, HB 3 added new sections of statute that establish requirements for the comptroller to review district resource-allocation practices, for the agency to conduct a financial solvency review for districts and project any related deficits for the school district general fund, and for districts to post adopted budgets on district websites. The HB 3 revisions also required the agency to remove from the FIRST system any indicator or performance measure that required a school district to spend at least 65 percent or any other specified percentage of district funds for instructional purposes and prevented the agency from lowering a financial accountability rating for failure to spend a specified percentage of operating funds for instructional purposes. Furthermore, HB 3, through revisions to TEC Chapter 12 and Chapter 39, made the state's systems of financial accountability applicable to charter schools. Specifically, TEC §12.104(b)(2)(L) makes Subchapter D of Chapter 39 applicable to open-enrollment charter schools, and TEC §39.082 specifically references a separate financial accountability rating system for open-enrollment charter schools. These statutory revisions applied beginning with the 2009–2010 school year. Effective June 1, 2009, HB 3 also repealed TEC §44.011, Spending Targets for District Expenditures, which previously required the agency to annually establish and publish proposed expenditure targets for each school district.

Revisions to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, were adopted in response to HB 3. Specifically, the agency adopted rules, effective May 31, 2010, at 19 TAC §109.1002(d), to revise FIRST and eliminate the 65% indicators as performance measures, and at 19 TAC §109.1002(e), to add charter financial accountability requirements through FIRST for open-enrollment charters (often referred to as Charter FIRST). Additionally, 19 TAC §109.1005 was revised to add open-enrollment charters to the financial management reporting requirement. The agency also proposed a new division at 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, Division 2, Financial Solvency, to address HB 3 financial solvency review requirements and amended version 14 of the *Financial Accountability System Resource Guide* (FASRG) at 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter C, Adoptions by Reference, to address other statutory changes.

The revised commissioner's rules related to financial accountability may be viewed at http://www.tea.state.tx.us/index4.aspx?id=2296 under the *Texas Administrative Code—Currently in Effect* link. Version 14 of the FASRG may be viewed under the Financial Audits section of the agency website at http://www.tea.state.tx.us/index2.aspx?id=1222&menu_id=645.

FIRST for Traditional (Non-charter) School Districts (School FIRST)

HB 3 required certain changes to the School FIRST financial accountability rating system, with the primary change being the addition of TEC §39.082(c), which prohibited the financial accountability rating system from including any indicator or performance measure that required a school district to spend at least 65 percent or any other specified percentage of district funds for instructional purposes and prohibited the agency from lowering a financial accountability rating for failure to spend a specified percentage of operating funds for instructional purposes. Additionally, financial accountability reporting requirements, as reflected in TEC §39.083, were amended to require the annual financial management report for a district to include a description of the data used to conduct a financial solvency review (see *Financial Solvency Review* section below).

The agency adopted revisions to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, effective May 31, 2010, at 19 TAC §109.1002(d) to revise FIRST in response to HB 3 and eliminate from the system the two noncritical indicators requiring that 65 percent of district expenditures be instructional in nature. The revised School FIRST system was effective for the 2008–2009 fiscal year as reflected in the 2010 School FIRST ratings.

Additionally, revisions will be made to 19 TAC §109.1005 to require districts to include in the annual financial management report under TEC §39.083 a description of the district's financial management performance based on a review of the financial solvency indicators adopted under TEC §39.082(b). These rule revisions will be effective for the 2010–2011 year and will impact reporting in fall 2011.

FIRST for Charter Schools (Charter FIRST)

HB 3, through amendments to TEC Chapter 12 and Chapter 39, made the state's systems of financial accountability applicable to charter schools. Specifically TEC §12.104(b)(2)(L) makes Chapter 39, Subchapter D, Financial Accountability, applicable to open-enrollment charter schools, and TEC §39.082 specifically references the requirement for the agency, in consultation with the comptroller, to develop and implement a separate financial accountability rating system for open-enrollment charter schools.

Prior to HB 3, the statute offered no specific guidance to the agency regarding how to address charter financial accountability in accreditation-status assignment. (See Section VII for historical background regarding the assignment of accreditation statuses to school districts and charter schools.) Therefore, in November 2008, the commissioner adopted amendments to 19 TAC Chapter 97, Planning and Accountability, to include open-enrollment charter schools in the accreditation process. Specifically, 19 TAC §97.1055 was amended to address charter accreditation by establishing substitute criteria when considering the financial performance of a charter operator in lieu of a financial accountability rating. The adopted amendments also established the process to be used concerning specific financial accountability assessments for charter operators. In accordance with the rules, the agency issued a Financial Accountability Review to charters in 2008 and in 2009. As stated in 19 TAC §97.1055(g), TEA reported the performance of each open-enrollment charter operator for informational purposes only for the 2006–2007 fiscal year as reflected by the 2008 Financial Accountability Review. In 2008–2009, the agency assigned accreditation statuses to charter schools for the first time under this adopted rule. However, financial accountability results were not considered in assigning the status. The 2007–2008 fiscal year, as reflected in 2009 findings, was the first year that the assessment resulting from the financial accountability review was officially reported and used in assigning accreditation statuses to charter schools.

In response to HB 3 requirements, 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, was amended effective May 31, 2010, to adopt the former Charter District Financial Accountability Review as the initial Charter FIRST measure for the 2008–2009 fiscal year, and Charter FIRST ratings were issued for the first time in 2010. The 2010 Charter FIRST included three foundational indicators of charter financial performance. These three indicators addressed the timeliness of submission of the charter's annual financial audit report, a comparison of the charter's total assets to total liabilities, and whether the annual financial report indicated a qualified or adverse opinion or an opinion that was disclaimed due to a scope limitation.

The agency is taking steps to expand the financial accountability indicators for charter schools through a subsequent rule adoption, with the expectation that an expanded system be in effect for the 2010–2011 fiscal year. The new indicators will address the areas of fiscal responsibility and data quality, budgeting, personnel, and cash management. The goal of the expansion is to create additional indicators that align, to the extent appropriate, with the financial accountability indicators established for traditional school districts.

As previously referenced, the agency adopted revisions to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, effective May 31, 2010, at 19 TAC §109.1002(e) to establish charter financial accountability requirements through Charter FIRST. 19 TAC §109.1003(b) also was added, listing the types of ratings open-enrollment charter schools may receive in Charter FIRST. In addition, 19 TAC §109.1005 was amended to add open-enrollment charter schools to the requirement to report the financial accountability ratings to parents and taxpayers, prepare and distribute an annual financial management report, and provide the public an opportunity to comment on the report at a public hearing. The revised commissioner's rules related to charter financial accountability may be viewed at http://www.tea.state.tx.us/index4.aspx?id=2296 under the *Texas Administrative Code—Currently in Effect* link.

The agency proposed revisions to the charter financial accountability rules in fall 2010 as an initial step to refine and expand Charter FIRST. It is expected that the rules will be adopted in late 2010 or early 2011 and effective with the 2010–2011 fiscal year. Proposed rules also may be viewed on the agency's administrative rules website at http://www.tea.state.tx.us/rules/home/.

Financial Solvency Review Requirement

The new TEC §39.0822, Financial Solvency Review Required, and §39.0823, Projected Deficit, as added by HB 3, direct the commissioner to develop a review process to anticipate the future financial solvency of each school district, including open-enrollment charter schools, and to take specific actions should a district trigger a financial solvency alert. TEC §39.0823 requires that the agency take certain actions for a district when the financial solvency review completed under TEC §39.0822 indicates a projected deficit for a school district general fund within the following three school years. Upon substantiation of that determination, a district is required to develop and submit a financial plan to the agency, which is to be approved by the agency only if the agency determines that the plan will permit the district to avoid the projected insolvency. The new statute further requires that the commissioner take action in regard to a district's accreditation status if the district fails to submit a required plan, fails to obtain agency approval of its plan, fails to comply with an approved plan, or if the agency determines in a subsequent school year that the approved plan is no longer sufficient or is not appropriately implemented.

In response to these HB 3 requirements, the agency is developing a review process to anticipate the future financial solvency of school districts and open-enrollment charter schools through an analysis of the school's revenues and expenditures for the preceding and current school year and as projected for the following two school years. The analysis will take into consideration, as applicable, the school's student-to-staff ratios relative to expenditures, the rate of change in the district's unreserved general fund balance, average staff salaries, student enrollment figures, the district's adopted tax rate, data reflected in the district's independent audit report, and actual financial data for the first quarter of the current school year.

In response to HB 3, and under the authority of TEC §39.085, the agency initiated a rule development process to implement the financial solvency review requirement. In developing the financial solvency review process, the agency consulted with school district financial officers and public finance experts. The agency's divisions of Financial Audits and Forecasting & Fiscal Analysis participated in roundtable discussions with school district financial officers and public finance experts in December 2009, January 2010, and April 2010 and proposed rules in September 2010 to implement the review process. The rule proposal requires school districts and open-enrollment charter schools to use an electronic template to submit to the agency first-quarter financial data for the current school year, information regarding district/school borrowing, data on administrative turnover, information on recent declarations of financial exigency (traditional districts) or bankruptcy (charter schools), and comments on any financial irregularities.

An evaluation of the data submitted by districts through the electronic template, along with the agency's financial analysis review, will determine whether a financial solvency alert is issued for the district. If the financial solvency review process indicates a projected deficit for a school district's general fund within the following three school years, in accordance with TEC §39.0823, the district is required to provide the agency with interim financial reports, supplemented by staff and student count data. If the interim financial data substantiate a projected deficit, the school district is required to provide the agency with a financial plan, which the agency will review and approve only if the agency determines the plan will permit the district to avoid the projected insolvency.

As referenced above, TEC §39.0823(c), as added by HB 3, requires the agency to take specific action regarding a district's accreditation status when a district is projected to have a deficit for the general fund within the following three school years and when related planning requirements are not met. (See Section VII, subsection *Accreditation Status Assignment*; *Financial Accountability and Financial Solvency Review Requirement* for additional information.) Specifically, the statute requires such a district to be assigned an Accredited-Warned status if the district fails to submit a required plan related to the projected deficit, fails to obtain agency approval of its plan, fails to comply with an approved plan, or if the agency determines in a subsequent school year that the approved plan is no longer sufficient or is not appropriately implemented. The commissioner adopted rules at 19 TAC §97.1055, effective on July 28, 2010, to state how the statutory requirements related to a financial solvency review and projected deficit affect accreditation statuses. In adopting the rule, the agency determined that it was necessary to address those circumstances in which, due to other areas of performance or accreditation concern, a district had otherwise earned a lowered accreditation status. Therefore, the agency incorporated language at 19 TAC §97.1055(b)(4), (c)(4), and (d)(4) to implement the requirements of statute regarding the lowering of a district's accreditation status in response to concerns related to a financial plan under TEC §39.0823 and to specifically address how concerns related to a financial plan would impact a district that already had earned a lowered accreditation status. The resulting rule establishes standards under which a district that had otherwise earned an Accredited-Warned status would be assigned an Accredited-Probation status if concerns related to the financial plan were identified. A parallel rule set is established for those districts already assigned an Accredited-Probation status.

The proposed rules on financial solvency and projected deficits, as updated to address public comment, are expected to be adopted with an effective date of December 2010. The first financial solvency review is projected to be calculated by the agency in spring 2011. Given the timing of the initial solvency calculation and the development by districts of any subsequent financial plans, it is anticipated that the first accreditation status assignment to be impacted by the financial solvency review will be in 2011–2012.

The revised commissioner's rules related to financial solvency reviews, which will be located in a new division at 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner's Rules Concerning Financial Accountability, Division 2, Financial Solvency, §109.1101, Financial Solvency Review, will be available upon final adoption at http://www.tea.state.tx.us/index4.aspx?id=2296 under the *Texas Administrative Code—Currently in Effect* link. The revised commissioner's rules related to accreditation, which are located in 19 TAC Chapter 97, Subchapter EE, may be viewed at the same administrative rules link.

Additionally, revisions will be made to 19 TAC §109.1005 to require districts to include in the annual financial management report under TEC §39.083 a description of the district's financial management performance based on a review of the financial solvency indicators adopted under TEC §39.082(b). These rule revisions will be effective for the 2010–2011 year and will impact reporting in fall 2011.

Resource Allocation Practices and Related Investigations

The new TEC §39.0821, Comptroller Review of Resource Allocation Practices, requires the comptroller to identify school districts and campuses that use resource-allocation practices that contribute to high academic achievement and cost-effective operations and rank the results of the review to identify the relative performance of districts and campuses, one purpose of which is to identify potential areas for district and campus improvement. A time line has not yet been determined for the completion of the first review of resource-allocation practices by the comptroller.

A reference to the new TEC §39.0821 was added at TEC §39.057(a)(12), under which the commissioner may order a special accreditation investigation when resource allocation practices under TEC §39.0821 indicate a potential for significant improvement in resource allocation. The TEC §39.057 changes were adopted in TEC, Chapter 39, Subchapter C, which becomes effective with the 2011–2012 school year. Therefore, the agency will not conduct special accreditation investigations related to resource-allocation practices earlier than the 2011–2012 school year.

The commissioner adopted rules at 19 TAC §97.1057(f), effective on July 28, 2010, to establish, upon completion by the comptroller of the required evaluation, factors the commissioner will consider in determining whether to impose accreditation sanctions based on resource-allocation practices. Specifically, the adopted rule notes that the commissioner shall consider the overall purposes of accreditation sanctions, as specified in 19 TAC §97.1053, Purpose, in determining appropriate sanctions for resource-allocation practices.

Posting of Adopted Budgets

HB 3 added TEC §39.084, which requires a district to post on the district's Internet website a copy of the budget adopted by the board of trustees. A district's Internet website is required to prominently display an electronic link to the district's adopted budget. The statute requires a district to maintain its adopted budget on the website until the third anniversary of the date the budget was adopted.

In response to the new statutory requirement, the *Financial Accountability System Resource Guide (FASRG) Module 2 – Budgeting, Section 2.6.1 – Statement of Texas Law*, was amended with the updated version 14 reflecting this change. 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter C, Adoptions by Reference, was amended to adopt version 14 of the FASRG, dated January 2010. School districts and open-enrollment charter schools were required to implement this statutory and regulatory change beginning with the 2009–2010 fiscal year and were required to post the 2009–2010 adopted budget to the district's Internet website.

Removal of Spending Targets

HB 3 repealed TEC §44.011, Spending Targets for District Expenditures, which required the agency to annually establish and publish proposed expenditure targets for each school district, including expenditures for instruction, central administration, and district operations. Under the prior statute, if a school board intended to exceed the proposed target, it was required to publish and adopt a resolution that included an explanation justifying its actions. Under these previous statutory requirements, the spending targets for instructional expenditures, central administrative expenditures, district operational expenditures, and any other category of expenditure designated by the commissioner were established and published annually by the commissioner. The repeal of TEC §44.011 was effective June 1, 2009.

In response to the repeal of TEC §44.011, the *Financial Accountability System Resource Guide (FASRG) Module 6 – Accountability, Section 6.3.5.3 – Spending Targets* was amended, with the updated version 14 reflecting this change. 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter C, Adoptions by Reference, was amended to adopt version 14 of the FASRG, dated January 2010. In alignment with the statutory and administrative rule revisions, spending targets were proposed by the agency for the last time in 2008–2009.

Financial Accountability Under House Bill 3 Transition Requirements

Subchapter D of Chapter 39 establishes the statutory authority for implementing financial accountability systems for school districts and open-enrollment charter schools. Section 71 of HB 3 establishes the time lines under which new HB 3 requirements related to financial accountability will be implemented. Section 71(a) of HB 3 notes the following:

(a) Except as provided by this section, this Act applies beginning with the 2009–2010 school year.

As referenced above, the agency has taken action to adopt rules in 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter AA, Commissioner’s Rules Concerning Financial Accountability, to implement revisions to the School FIRST and Charter FIRST systems for the 2009–2010 fiscal year. The agency is in the process of expanding the indicators in the Charter FIRST system and will adopt revisions to the system effective with the 2010–2011 fiscal year. Additionally, rules have been adopted by reference in 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter C, Adoptions by Reference, to implement revisions requiring districts to post adopted budgets to their websites beginning with the 2009–2010 fiscal year. As previously referenced, the agency currently is in the process of adopting rules at 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter AA, Commissioner’s Rules Concerning Financial Accountability, Division 2, Financial Solvency, to implement the financial solvency review and projected deficit requirements and will issue financial solvency review findings for the first time in spring 2011.

Furthermore, the requirements of TEC, Chapter 39, Subchapter C, Accreditation, establish a district’s performance in the financial accountability rating system as a required consideration in the assignment of an accreditation status to a district. TEC §39.116, Transitional Interventions and Sanctions, establishes certain HB 3 transition requirements related to accreditation status assignment. TEC §39.116(a) notes that, during the period of transition to the accreditation system established under HB 3, to be implemented in August 2013, the commissioner may suspend the assignment of accreditation statuses for the 2011–2012 school year.

The agency interprets TEC §39.116(a) to allow the assignment of 2012–2013 accreditation statuses, which are based partially on 2011–2012 academic performance, to be suspended. However, the agency proposes to assign accreditation statuses to districts for 2012–2013 and has adopted rules to establish a framework for accreditation status assignment during the transition period.

The agency notes that a district's accreditation status may be influenced by many factors other than academic performance, namely the district's financial accountability rating results and other factors as referenced in TEC §39.052 and 19 TAC §97.1055. Therefore, the agency has determined that it is reasonable to use other available data for the purposes of assigning a 2012–2013 accreditation status to districts. For example, absent other concerns, a district that was assigned an Academically Unacceptable academic accountability rating in 2011 and a Substandard financial accountability rating in 2012 would earn a 2012–2013 Accredited-Warned status. Additionally, any data and information contributing to a district’s 2011–2012 accreditation status results will be carried forward in assigning a 2012–2013 accreditation status to a district.

The commissioner has adopted rules at 19 TAC §97.1055(a)(8)-(9), effective July 28, 2010, that address procedures by which an accreditation status may be assigned to districts in 2012–2013.