
School FIRST and the Financial Solvency Review Process

What you will learn:

- What School FIRST is and what it was designed to accomplish
- The status of the so called “65% rule”
- The disclosures required by the School FIRST system
- Elements of the Financial Solvency Review process
- Consequences of a projection of insolvency

Key points:

- Districts are given yearly ratings.
- Annual public hearings are required.
- Annual reports are required.
- Districts must provide financial data to TEA regarding financial solvency.
- TEA may require the development of a financial plan to avert insolvency.
- Accreditation status impacted without plan compliance.

About the Author:



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Paul began work as an attorney with the Texas Workforce Commission until 1995, when he came to TASB to represent members of the Risk Management Fund’s Unemployment Compensation program. Paul joined the TASB Legal Services staff in October 2000. His primary duties included updating TASB Policy Service local policy manuals used by most Texas school districts, junior colleges and education service centers. In March 2009, Paul returned to TASB Risk Management as the Division Director for Risk Management Legal and Regulatory Affairs. Paul now provides legal support for all areas of TASB Risk Management.

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Introduction

The School Financial Integrity Rating System of Texas, or School FIRST, a financial accountability system for Texas school districts, was developed by the Texas Education Agency (TEA) in response to legislation passed in 1999. In 2006, performance under School FIRST was added as a consideration for accreditation, along with academic performance. Finally, in 2009, the legislature enacted the Financial Solvency Review process, which requires districts to submit key financial data to TEA¹. This data is then used to address any future solvency issues.

School FIRST is designed to encourage Texas public schools to manage their financial resources to provide the most money possible for direct instructional purposes. The system is used to collect data and monitor the financial performance of public school districts and more recently, charter schools. TEA will consider a district's School FIRST rating when assigning an accreditation status. Additionally, a district's accreditation status may be impacted in cases where a deficient financial plan is submitted to TEA in response to the solvency review process.²

The Texas Education Code requires the commissioner of education to adopt rules for the implementation and administration of the FIRST system, as well as for the separate Financial Solvency Review process.³ These rules are found in the Texas Administrative Code, Title 19, chapter 109, subchapter AA.

School FIRST requires districts to report certain financial data to TEA, TEA to assign a financial accountability rating to each district, and districts to develop an annual financial management report for taxpayers and parents based on the financial data, the accountability rating, and financial disclosures. The Financial Solvency Review process provides for the collection of financial data and an analysis of the submitting districts future financial position. Each process will be discussed separately below.

The FIRST System

Financial Accountability Ratings

Under School FIRST, districts are assigned one of four financial accountability ratings to school districts: Superior Achievement, Above-Standard Achievement, Standard Achievement, or Substandard Achievement.

School FIRST ratings are based on staff and student data reported for a school year and financial data reported for the corresponding fiscal year (12-month period beginning either July 1 or September 1 of each year). School districts provide information to TEA through various financial reports, audit reports, and data reported through PEIMS.

After TEA receives a district's financial information, TEA completes a School FIRST rating worksheet for each district. Under School FIRST rules, the rating worksheet contains 22 questions, called *indicators*. The indicators are split into critical and noncritical indicators. The

noncritical indicators total a potential 95 points, with each individual indicator worth a maximum of five points. The critical indicators are not scored—they are pass/fail. However, answers of “no” on certain critical indicators will automatically result in a substandard achievement rating. A district’s rating is a function of the aggregate number of points on the noncritical indicators and answers to the pass/fail critical indicators.

Each indicator on the rating worksheet is designed to assess the district’s management of financial resources. Since School FIRST was created in 2002, it has measured indicators such as ratios of students to teachers, general fund balance, investment earnings, total tax collection, and debt related expenditures.

65% Rule Removed

In 2005, Governor Perry issued an executive order directing the commissioner of education to include an indicator in School FIRST on whether each district is using 65% of its funds for instructional purposes—the “65% Rule.” The governor directed the commissioner to use the definition of “instructional” spending developed by the federal National Center for Education Statistics (NCES). The federal definition of “instruction” includes money spent by school districts on teachers and instructional aide salaries, but not money spent on other services, such as counselors and librarians.

In response to concerns that the federal definition of instructional purposes was too narrow, TEA created a second, broader state definition of “instruction” for use in School FIRST. Both definitions were incorporated into School FIRST to determine whether a district had met the 65% threshold for spending on instructional purposes. Starting with the 2006-07 school year and 2007 fiscal year, these two definitions were incorporated into two 65% indicators on the rating worksheet.

In 2009, the legislature removed these spending targets from the School FIRST ratings worksheet beginning with ratings for the 2008-09 school year.

Annual Report

Additionally, School FIRST requires a school district to report financial accountability ratings to parents. Districts are required to prepare and distribute an annual financial management report, including a description of the district’s financial management performance in School FIRST.⁴

The annual financial management report must include a description of the district’s current School FIRST rating, and the district’s performance under each of the indicators, as noted by TEA on the ratings worksheet. The report must also contain information on the previous year’s rating and performance on the indicators.⁵ TEA provides a template to help in the compilation of this report.

TEA also encourages districts to provide additional information in the financial management report that will be beneficial to taxpayers, especially information explaining special circumstances that may have affected the district’s performance under one or more of the indicators.⁶

After preparing the annual financial management report, each district must hold a public hearing to distribute it.⁷ The public meeting to present the report containing the district’s School FIRST rating may be combined with a scheduled regular meeting of the board of trustees but must be held within two months of receipt of the district’s final School FIRST rating from TEA.

The School FIRST rules require the public hearing to be held at a location in the district's facilities. The board must give notice of the hearing to property owners in the district and to parents of district students. In addition to the standard notice requirements of the Texas Open Meetings Act, notice of the hearing, including date, time and location, must be provided in a newspaper of general circulation in the district once a week for two weeks prior to holding the public hearing. The first notice in the newspaper must be published 14-30 days prior to the public hearing.

If there is not a newspaper published in the county in which the district's central administration office is located, then the notice should be published in the county located closest to the county seat of the county in which the district's administration office is located. Additionally, notice of the hearing must be given through electronic mail to media serving the district.⁸

Other Disclosures

In the 2006 changes to School FIRST, TEA also revised the rules to require that the annual financial management report developed by each district after receipt of a final School FIRST rating include numerous disclosures of board member and superintendent financial information.

Under the current School FIRST rules, the annual financial management report should include:

- The superintendent's current employment contract.
- Total reimbursable expenses incurred by the district on behalf of the superintendent and each board member.
- Compensation and fees received by the superintendent from another school district or any other outside entity in exchange for professional consulting or other personal services.
- Certain gifts received by executive officers, board members, and their immediate family members, from outside entities.
- Business transactions between a board member and the school district.⁹

The Financial Solvency Review Process

Texas law now requires a school district to provide TEA with financial information that will allow TEA to anticipate the district's future financial solvency. The purpose of the review is to have TEA alert a district to circumstances that could lead to financial insolvency.¹⁰ In its review, TEA will evaluate financial data including the district's annual audits for the past two school years, PEIMS financial actual data for the past two school years, the school districts tax rate data, as well as a number of other financial indicators provided through PEIMS.¹¹ TEA may also consider historical and projected student-to-staff ratios relative to expenditures, average staff salaries, the rate of change in the unreserved general fund balance, the number of students enrolled in the district, and other financial indicators as provided by rule.¹² TEA will notify the district if the review shows a student-to-staff ratio that is significantly outside the norm, a rapid depletion of the general fund balance, or a significant discrepancy between submitted budget figures and projected revenues and expenditures.¹³ If a district receives a notification of this nature, TEA may extend the financial solvency review and require additional documentation. If an evaluation of the collected information indicates a projected deficit within the next three school years, the district must submit a financial plan designed to avoid insolvency. TEA will

review and approve the plan and monitor its implementation for up to three years.¹⁴ All financial plan approval decisions made by the commissioner are final and may not be appealed.¹⁵

The commissioner will assign an Accredited-Warned status to a district that is required to develop and submit a financial plan if the district fails to:

- submit a plan to avoid the projected deficit;
- receive approval for the plan from TEA; or
- comply with a TEA-approved plan.

The district will also receive an Accredited- Warned status if TEA determines in a subsequent school year, that the plan is no longer sufficient or has not been appropriately implemented.¹⁶

It is important to note that all documentation generated and gathered in the process of determining a district's financial solvency are considered working papers and not subject to open records requests. However, if a district is required to submit a financial plan, those documents will be subject to open records request as permitted by statute or rule.¹⁷

Conclusion

School FIRST ratings are based upon data reported to and reviewed by TEA. The School FIRST worksheet is used as a tool by TEA but is not actually completed by reporting districts. The required disclosures are made in the district's public financial management report made after the final rating is received. Written appeals of preliminary School FIRST ratings are allowed prior to the ratings becoming final.

The Financial Solvency Review process is a provision requiring school districts to submit information to TEA to allow the agency an opportunity to evaluate a districts financial position and project that position forward. Districts found to be in danger of insolvency are required to submit a financial plan to TEA and to follow the plan that is ultimately approved. Failure to submit a plan or to comply with an approved plan will result in an accreditation warning for the district.

This document is provided for educational purposes only and contains information to facilitate a general understanding of the law. It is neither an exhaustive treatment of the law on this subject nor is it intended to substitute for the advice of an attorney. It is important for the recipient to consult with the district's own attorney in order to apply these legal principles to specific fact situations.

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¹ Tex. Educ. Code § 39.0822.

² 19 Tex. Admin. Code § 109.1101(f).

³ Tex. Educ. Code §§ 39.081-.085.

⁴ 19 Tex. Admin. Code § 109.1005(a), (c).

⁵ 19 Tex. Admin. Code § 109.1005(b)(1).

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- 6 19 Tex. Admin. Code § 109.1005(b)(3).
 - 7 19 Tex. Admin. Code § 109.1005(c).
 - 8 19 Tex. Admin. Code § 109.1005(c).
 - 9 19 Tex. Admin. Code § 109.1005(b)(2).
 - 10 Tex. Educ. Code § 39.0822.
 - 11 19 Tex. Admin. Code § 109.1101(c).
 - 12 19 Tex. Admin. Code § 109.1101(d)(1)-(3).
 - 13 19 Tex. Admin. Code § 109.1101(d)(4).
 - 14 19 Tex. Admin. Code § 109.1101(d)(5)(e).
 - 15 19 Tex. Admin. Code § 109.1101(g).
 - 16 19 Tex. Admin. Code § 109.1101(f).
 - 17 19 Tex. Admin. Code § 109.1101(d)(6).