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August 12, 2010

Mr. Jaime Ayala, Assistant Superintendent, Business  
 Colton Joint Unified School District  
 1212 Valencia Drive  
 Colton, CA 92324-1798

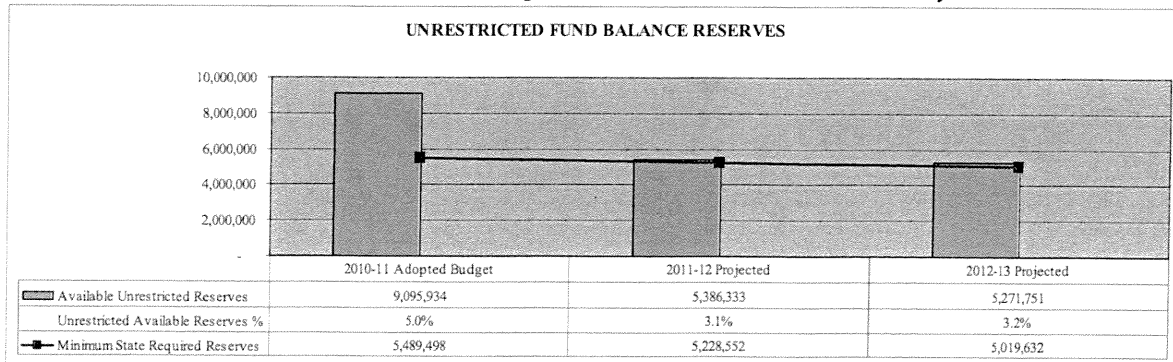
Dear Mr. Ayala:

Thank you for the submission of the district's 2010-11 Adopted Budget. We recognize the district's efforts in the development of a budget and financial plan that provides for the ongoing financial stability of the district in these tough economic times. While the state has not yet approved a 2010-11 State Budget, our office directed districts to utilize the Governor's May Projected Budget assumptions to build their 2010-11 Adopted Budgets. Our office provided details of those assumptions in the BASics newsletter and common message bulletin.

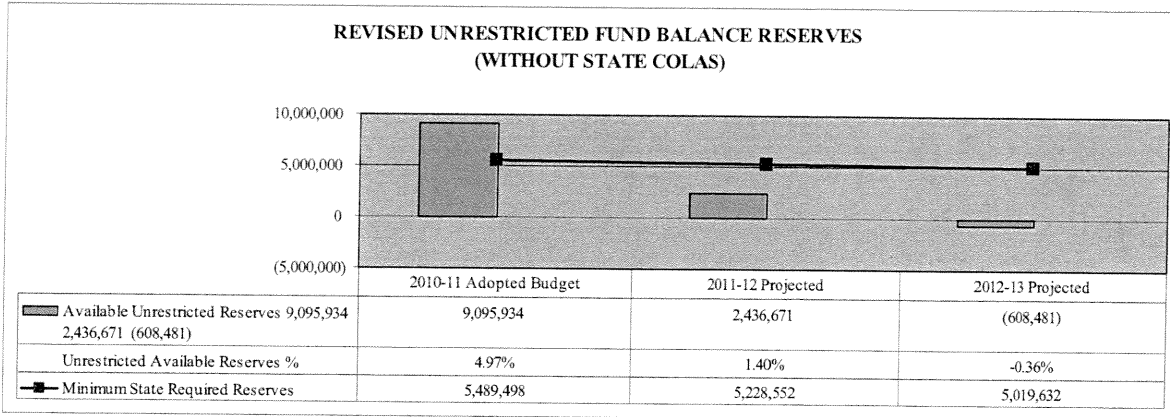
The 2010-11 Adopted Budget of the Colton Joint Unified School District has been reviewed and **Conditionally Approved** pursuant to the provisions of Education Code Section 42127 (c)(d) and based on the board's recognition of the need for \$12.67 million in budget reductions in the 2011-12 fiscal year and an additional \$12.5 million in the 2012-13 fiscal year.

As adopted by the district's Governing Board, the budget reflects an unrestricted ending balance reserve in the General Fund and Special Reserve Fund (Fund 17) of 4.97%. The district is projecting unrestricted ending fund balance reserves at 3.09% in 2011-12 and at 3.15% in 2012-13. The district is meeting 2010-11 state reserve levels and ongoing operational needs primarily through the use of one time only carryover balances which will be exhausted by 2011-12.

For fiscal years 2011-12 and 2012-13, in order to meet the state required minimum reserve level of 3%, the district has submitted a fiscal action plan identifying potential board approved budget reductions and a signed board resolution #10-24 for fiscal years 2011-12 and 2012-13 recognizing \$25.17 million in on-going and one-time budget reductions to be implemented in a combination of these years.



However, our review noted that the multiyear financial projections include cost of living adjustments (COLAs) of 2.10% for 2011-12 and 2.40% for 2012-13 as identified on the School Services of California (SSC) dashboard. Due to the state's current financial position, SSC and our office recognize the uncertainty of actual receipt of these funds. Our office had indicated in Bulletin #10-140, May Revision-Common Message, that districts including these COLAs also set aside a board designated unrestricted reserve or include in their fiscal action plan additional budget reductions (contingency plan) that can be implemented, should these funds not materialize as anticipated. In our analysis, reducing the anticipated revenues by these amounts indicates that for fiscal years 2011-12 and 2012-13, the district would not meet the state required minimum reserve level of 3%. The district has **not** approved a Board Resolution that authorizes ongoing expenditure reductions or provided an additional contingency plan in the event the state COLAs are not realized.



**Under the Conditionally Approved budget process, in order for our office to approve the district's Revised Adopted Budget, we need to have evidence that the board has taken action(s) to approve a fiscal solvency action plan, including contingencies for potential non-receipt of State COLAS, for the two subsequent fiscal years that clearly identifies,**

- 1. if the board approved reductions are one time or ongoing;**
- 2. for which fiscal year the reductions will occur;**
- 3. if the reductions need to be negotiated with the bargaining units and the current status of those negotiations; and**
- 4. an estimated dollar amount of savings expected to be realized for each reduction.**

**Specifically, the fiscal solvency and contingency plans must address the following areas:**

- **Reduction of \$1,013,682 in fiscal year 2010-11 for State Fiscal Stabilization funds which are included in both the estimated 2009-10 revenues and in 2010-11 revenue projections. Please submit copies of the budget transfers removing these revenues in 2010-11.**
- **Additional details on the district's fiscal action plan for \$25.7 million in on-going reductions, including any further board discussions, authorizations or updates to this plan. Currently only \$12.6 million has been identified in specific reductions. We need to see a plan for the full level of reductions.**
- **Adjust current budget projections to include any recently added positions to ensure that all ongoing costs are accounted for in all fiscal years. For FY 2010-11, these adjustments will need to be made as budget revisions in the financial system, and the ongoing impact included in the revised multiyear projections. Please provide a summary of these additional positions as part of the submission.**
- **A contingency plan identifying approximately \$2.9 million in on-going unrestricted board approved budget reductions prior to 2011-12 to offset the state aid and categorical program COLAs.**

- A contingency plan identifying approximately \$6.3 million in on-going unrestricted board approved budget reductions in or prior to 2012-13 to offset the state aid and categorical program COLAs.

This additional information must be provided as part of the revised Adopted Budget submission to be board approved and submitted to our office no later than September 8, 2010. Under the Conditional Approval process, our office has rolled your tentative budget to the Adopted stage allowing for current year budget revisions, but will not roll the final budget to approved status until after review of the Revised Budget plan submitted September 8, 2010. Revised multiyear financial projections and assumptions must be included in the SACS2010 software and a new budget submission with all applicable forms submitted at that time. The district does need to also hold a public hearing prior to the approval of this revised budget document pursuant to Education Code 42103. Due to the high level of budget reductions required to remain fiscally solvent, some reductions may need to be implemented beginning in the current 2010-11 fiscal year in order to limit the impact in the two future years.

Under Education Code 42127(d), our office may assign a fiscal advisor to assist the district with the development of budget reductions in compliance with the above requirements. Our office will be contacting the district chief business official to determine if this assistance would be beneficial. A summary of the conditional budget approval process is attached for your review.

The **Conditional Approval** of the Adopted Budget is based on an assessment and analysis of the following additional major components of the district's budget:

- Average Daily Attendance (ADA) & Enrollment Projections
- Revenue and Expenditure Projections (Deficit spending trends)
- Categorical Flexibility and Federal Stimulus Projections
- Salary Settlements Status
- Long Term Debt
- Cash Flow

The budget is a dynamic document that reflects the Governing Board's plan for receipt of revenues and utilization of expenditures to meet the goals and financial obligations of the school district in the coming year based on the information known to the district and board at the time of adoption. To assure that the budget continues to reflect that plan, the following items should be taken into consideration:

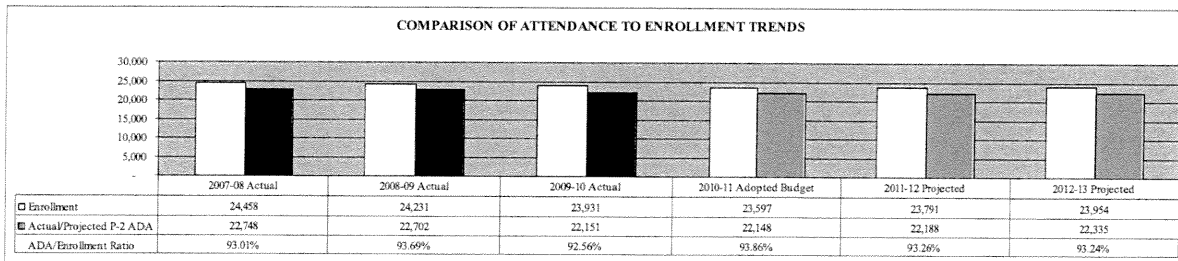
- **AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2010-11 P-2 ADA of 22,147.78 or a -0.01% decline over prior year ADA (P2). Compared to the enrollment projection of 23,597, the district is anticipating an attendance ratio of 93.86%. This ratio is 0.89% higher than the three year historical average of 92.97%.

Additionally, the district is projecting a 0.18% change in ADA and 0.82% change in enrollment for 2011-12 for an attendance ratio of 93.26% and 0.67% change in ADA and 0.69% change in enrollment for 2012-13 for an attendance ratio of 93.24%. The state's standard is based on the average ratio of actual ADA to enrollment over the past three years, plus 0.50%. Based on the enrollment and ADA projections for the current fiscal year, the district is not within the state's standard of 93.5%. The district has indicated that the current year is projected slightly higher due to a new Saturday school program for ADA recovery. We caution the district not to include ADA increases until actually realized, especially for new programs, in the event the higher ADA does not materialize as anticipated and state aid revenue projections need to be reduced. The district does not appear to be projecting ADA based on historical trends. We recommend that the district continue to

closely monitor changes in attendance and enrollment. If the projected ADA or enrollment does not materialize as anticipated, the board will need to adjust the budget accordingly.

Another factor to be reviewed by the district in 2010-11 is the reopening of the Nova Meridian Charter Academy under the State Board of Education oversight. Since this charter is located within the district boundaries, it may draw students from existing schools within the district, reducing ADA in the current and future years.

The following chart displays the district's ADA and enrollment in the three prior years along with the district's projected ADA and enrollment for the budget and two subsequent fiscal years. Since a significant portion of a school district's revenue is derived from ADA, it is imperative to closely monitor the correlation between enrollment and ADA.

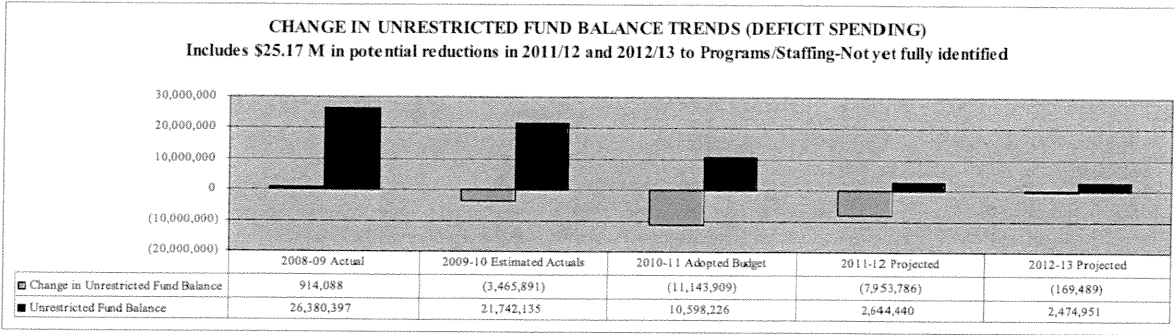


- UNRESTRICTED REVENUE AND EXPENDITURE PROJECTIONS/DEFICIT SPENDING**

– The district is projecting unrestricted expenditures to exceed revenues by \$11,143,909 in the current fiscal year primarily due to reduction in state aid and on-going operational costs. The district is continuing this trend of deficit spending in fiscal year 2011-12 by \$7,953,786 and in fiscal year 2012-13 by \$169,489. However, these deficits will be greater if the district is not able to identify and implement the \$25.17 million in ongoing unrestricted reductions in the two future years. Additionally, the inclusion of the state COLAs in the two subsequent fiscal years of \$2.9 million and \$6.3 million is lowering the reflected deficit spending trend. If those COLAs do not materialize as anticipated, the district's deficit spending will significantly increase and lead to fiscal insolvency. Our office has requested the district also build into its fiscal solvency plan, a contingency plan of reductions equaling the state COLA revenues, should these revenues not materialize as anticipated. Anticipated deficit spending should be for one time, non-recurring expenditures to avoid depletion of the district's on-going unrestricted ending fund balance.

The district's deficit spending is **not** within the established state standards for the current and the first subsequent fiscal year. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

The following chart displays the actual Unrestricted General Fund balance change for the prior two fiscal years and the projected change based on the adopted budget and board approved multi-year financial projections for the 2008-09 through 2012-13 fiscal years. The data below reflects the inclusion of the \$25.17 million in potential ongoing budget reductions that have not been fully identified or implemented by the district. The data also reflects the inclusion of state COLAs in the two subsequent fiscal years.



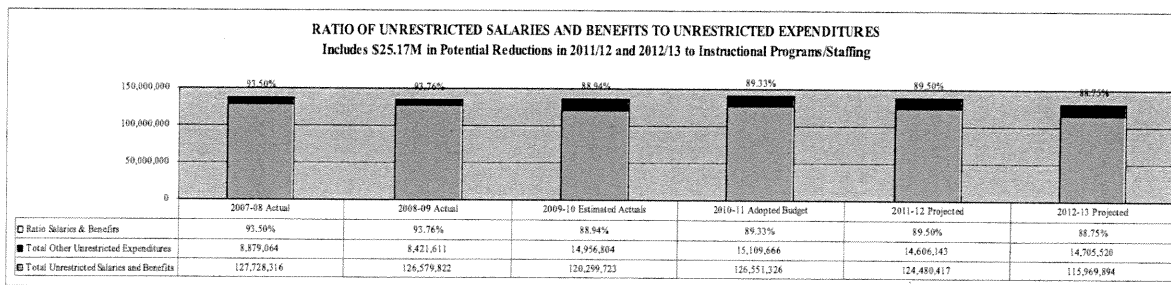
- CATEGORICAL FLEXIBILITY PROJECTIONS** – Our review indicates that the district appears to be projecting for the Tier 3 categorical programs correctly as unrestricted programs in the 2010-11 fiscal year. The state has provided districts with the opportunity to utilize this flexibility for any educational purposes until the end of 2012-13. Final funding determinations on some programs have not yet been finalized for the 2010-11 fiscal year. Our office recommends the district conservatively project revenues and expenditures in these programs until final allocation information is received. Keep in mind that this flexibility ends as of June 30, 2013. The district needs to make contingency plans on how the district will respond, if this flexibility is not extended with additional legislation.
- FEDERAL STIMULUS PROJECTIONS** – Our review indicates that the district is utilizing carryover from the Federal Stimulus funding that was received in 2009-10 for Title 1, IDEA and the State Fiscal Stabilization Fund (SFSF). However, the district did not make the reductions in the programs that were adjusted due to the QEIA funding to be backfilled by additional SFSF funding. The district budgeted these SFSF funds of \$1,013,682 to be spent in fiscal year 2010-11, as a result, the district has duplicated these revenues and will need to reduce federal revenues with the revised budget submitted to our office on or before September 8, 2010. Keep in mind that these funds are one time only in nature and should not be used for ongoing operational expenditures to the extent possible. These funds must be completely utilized prior to September 30, 2011.
- SALARY SETTLEMENTS** – The information submitted with your Adopted Budget indicates that salary negotiations have not been concluded for the 2009-10 or 2010-11 fiscal years. The documents also indicate that there are no potential increases included in the adopted budget or subsequent fiscal years, other than step and column adjustments. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 7%, since the district currently does not have a cap on the employer cost of health benefits. This escalating cost increase for full health benefit coverage is one of the factors contributing to the ongoing deficit spending projected by the district. Please keep our office apprised monthly of the district’s status in negotiations for 2009-10 and 2010-11.

An analysis and disclosure, including the impact on the current operating budget and multi-year financial projections, whether a cost or savings, for all proposed or tentative agreements, and Memorandums of Understanding (MOUs) is due in our office **at least ten days prior to adoption by the board**. This analysis is required to be publicly disclosed at a board meeting regardless of whether there is an increase, decrease, or no change in expenditures or language. Budget transfer documents implementing the adjustment(s) must also be provided to the county office no later than 45 days after approval of the agreement by the Governing Board. If the costs associated with a negotiated salary or benefit increase reduce the available unrestricted ending balance below the required state minimum reserve level in the current and/or two subsequent fiscal years, the district Governing Board will be

required to take action to reduce other expenditures in order to maintain the required state reserves in the current and two subsequent fiscal years.

An outline of the disclosure procedures and a copy of the required disclosure documents are available in an EXCEL format on the San Bernardino County Superintendent of Schools, Business Administrators website ([http://www2.sbcss.k12.ca.us/sbcss/busServe/bas\\_FormFI.php](http://www2.sbcss.k12.ca.us/sbcss/busServe/bas_FormFI.php)), under AB1200/AB2756 Salary disclosure. Instructions for completing these forms are also available on the website.

The majority of a school district's budget is spent on salaries and benefits. The following chart shows the percentage of unrestricted salaries and benefits to the total unrestricted general fund expenditures for the prior three years, adopted budget and multi-year projections. The state's established standard is based on an average of the district's prior three years of unrestricted salaries to total unrestricted expenditures. The district's ratio of unrestricted salaries and benefits to total unrestricted expenditures are within the state's established standard, however this represents 91.1% of unrestricted expenditures are being consumed by salary and benefit costs. If salaries and benefits are growing at a rate faster than total expenditures, these costs will consume a disproportionately greater share of the district's resources, putting significant pressures on the rest of the budget. We recommend that the district monitor these ratios and take them into consideration as part of collective bargaining negotiations and oversight of position control. The chart below reflects the data as submitted by the district which includes the \$25.17 million in anticipated reductions in 2011-12 and 2012-13. A large proportion of the anticipated reductions include elimination of instructional programs and reduction of staff which affects this comparison. The district prorated the reductions across the multiyear salary and benefit projections. Once the final reductions are identified and implemented, this comparison could change substantially.



- LONG TERM DEBT** – The Adopted Budget includes non-voter approved long-term debt of \$11,508,066 which constitutes 6.29% of the district's general fund budget. The debt repayment is budgeted in the General and Child Development Fund. The district should closely monitor the revenue stream of these funds to ensure adequate revenues are received to cover the current and ongoing debt repayment schedules for principal and interest payments. The district should take appropriate action if revenues do not materialize as anticipated. Any district with a debt ratio to the general fund of greater than 25% is recommended to increase their minimum unrestricted reserve levels to twice the state standard to ensure funds will be available to meet the repayment obligations.
- CASH FLOW** – Our office reviewed the district's anticipated 2010-11 cash flow projections. The district anticipates having a shortfall in the months of May and June 2011 and has indicated that it will utilize inter-fund borrowing to provide temporary cash flow in these months. If the district initiates board actions to utilize inter-fund borrowing within the last 120 days of the fiscal year, the funds can be repaid in the subsequent fiscal year 2011-12. Additionally, the district is utilizing a

temporary loan from the County of San Bernardino Board of Supervisors in the form of an advance on property taxes or a constitutional advance of \$7,877,508 which is scheduled to be repaid 50% in December 2010 and 50% in April 2011.

The 2010-11 State Budget has not been finalized as of this date. Our review has been based on the latest information available to this office within the Governor's May Revise Budget Projections. Please remember that Education Code Section 42127(i)(4) requires that:

*"Not later than 45 days after the Governor signs the annual Budget Act, the school district shall make available for public review any revisions in revenues and expenditures that it has made to its budget to reflect the funding made available by that Budget Act".*

We anticipate a timely year-end closing of the 2009-10 financial records by the district, along with the annual audit by the district's external auditors which will determine the actual beginning fund balances for 2010-11 and audited ending balances for 2009-10. These actions will also ultimately affect the availability of reserves for the 2010-11 operating budgets. The unaudited actuals report is due to our office per Education Code Section 42100 on or before September 15, 2010, and the audit report is due on or before December 15, 2010.

Any questions concerning the review of the district's 2010-11 Adopted Budget may be addressed to me at (909) 777-0745.

Sincerely,



Cynna Hinkle  
Business Services Advisor  
Business Advisory Services

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Attachments:

FCMAT Fiscal Indicators

Disapproved/Conditionally Approved Budget Process Flowchart

CC: Dr. Gary Thomas, County Superintendent, SBCSS  
Mr. Ted Alejandre, Assistant Superintendent, Business, SBCSS  
Mrs. Teri Kelly, Director, BAS, SBCSS  
Mr. James A. Downs, Superintendent, CJUSD  
Mr. Mel Albiso, Board President, CJUSD