EDUCATION: TOMORROW'S FUTURE

SAN BERNARDINO COUNTY SUPERINTENDENT OF SCHOOLS

Gary S. Thomas, Ed.D., Superintendent

January 12, 2011

Mr. James A. Downs
Colton Jt. Unified School District
1212 Valencia Dr.
Colton, CA 92324-1798

Dear Mr. Downs:

Thank you for the submission of the Colton Joint Unified School District 2010-11 First Interim Financial Report.

In these tough economic times, the district and governing board need to take actions to maintain fiscal stability in the current and two subsequent fiscal years. The projections submitted to our office indicate that the district is not projecting to meet the state minimum reserve level of 3% in the 2011-12 and 2012-13 fiscal years. Based on our analysis, the data provided supports the board's ***Qualified certification*** of the district's financial condition which indicates the district may not be able to meet all financial obligations in the current or subsequent two fiscal years.

Our office has provided for a fiscal advisor, Michelle McClowery, to assist the district and will continue to provide this assistance until the district's board can approve and implement a specific fiscal action plan which provides for fiscal solvency in the current and two subsequent fiscal years.

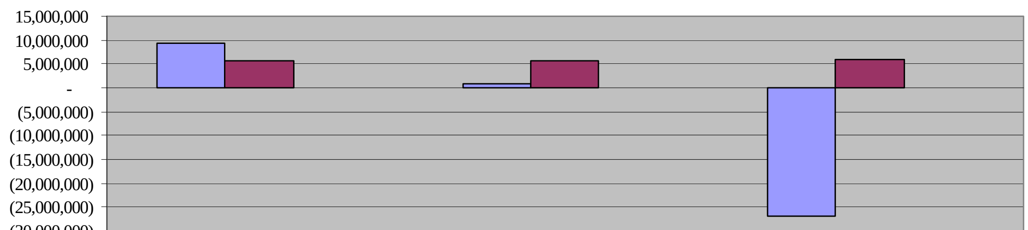
The Office of the San Bernardino County Superintendent of Schools has reviewed the First Interim Financial Report submitted for the period ending October 31, 2010. Our review included an assessment and analysis of the following major components of the district's report:

- Unrestricted Ending Fund Balance and State Minimum Reserves
- Unrestricted Deficit spending trends
- Average Daily Attendance (ADA) & Enrollment
- Revenue and Expenditure Projections
- Ending cash position and monthly cash flows
- Staffing Projections/Salary Settlements
- Multi-year Financial Projections
- Long Term Debt

- **UNRESTRICTED ENDING FUND BALANCE AND STATE MINIMUM RESERVES –** As certified by the district's Governing Board, the First Interim Financial Report projects an unrestricted ending balance reserve in the General Fund of 4.9% for 2010-11. The district is projecting unrestricted ending fund balance reserves at 0.41% in 2011-12 and at -13.68% in 2012-13, including the utilization of $3.6 million in reserves from the Special Reserve Fund for other than capital outlay (Fund 17).

For fiscal years 2011-12 and 2012-13, the district does not meet the state minimum reserve level of 3% of total expenditures and uses. As a part of the approval of the Revised Adopted Budget in September 2010, the board approved resolutions identifying the need for expenditure reductions beginning in fiscal year 2011-12. The board must now identify and approve a specific fiscal action plan implementing expenditure reductions and/or revenue enhancements that will enable the district to meet ongoing financial obligations, both in budget and actual cash needs, in the current and two subsequent fiscal years. The specific action plan will need to identify if the expenditure reductions or revenue enhancements are one time or ongoing; for which fiscal year the reductions/enhancements will occur; if the reduction needs to be negotiated with the bargaining units; and an estimated dollar amount of savings for each fiscal year. This additional information must be provided as part of the Second Interim Financial Report submission and be implemented and/or negotiated with bargaining units, as needed, in order to justify a "Positive" certification at that time. If the district board has not taken action to approve or has not been able to negotiate major elements of the fiscal plan with the district's bargaining units, as applicable, then a "Qualified" certification would be required. The Second Interim report is due to our office no later than March 16, 2011.

UNRESTRICTED FUND BALANCE RESERVES



	2010-11 Projected	2011-12 Projected	2012-13 Projected
Available Reserves	9,307,225	792,366	(26,972,590)
Minimum State Required Reserves	5,699,058	5,752,311	5,913,568
Unrestricted Available Reserves %	4.90%	0.41%	-13.68%

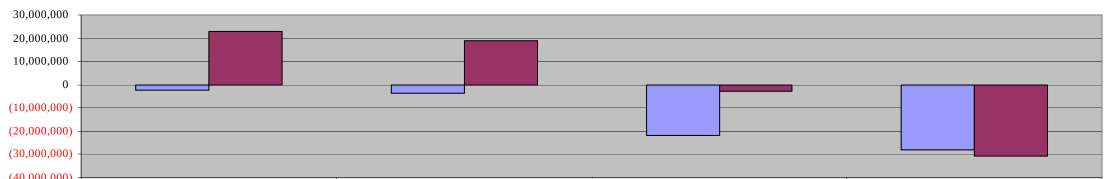
The First Interim Financial Report provides the Governing Board with the opportunity to revise and review its operating budget plan based on the most recent State Budget information and local decisions since the Adopted Budget. This plan should incorporate any updated revenue projections and utilization of expenditures to meet the goals and financial obligations of the school district in the coming year and the two subsequent fiscal years. To ensure that the district's operating budget continues to reflect that plan, our office noted the following items that should be taken into consideration:

- **UNRESTRICTED DEFICIT SPENDING –** The district is projecting unrestricted expenditures to exceed revenues by $3,679,353 in the current fiscal year, primarily due to the reduction of state aid and on-going operational costs. The district is utilizing a large degree of one time revenues and carryover balances which is reducing the deficit spending in the current fiscal year. The district is projecting to substantially increase this ongoing trend of deficit spending in fiscal year 2011-12 by $21,792,954 and in fiscal year 2012-13 by $27,819,793. This ongoing and increasing deficit spending appears to be attributed to state revenue reductions, loss of one-time federal ARRA and Education Jobs bill funding and other on-going operational costs. This ongoing deficit spending is causing the district to substantially deplete the unrestricted General Fund balance within 2011-12 and causing the district to be fiscally insolvent by 2012-13, unless immediate actions are taken to reduce ongoing unrestricted expenditures. This level of deficit spending is also causing the district to borrow heavily from other district funds in order to meet cash needs due to the state revenue deferrals. Anticipated deficit spending should be for one time, non-recurring expenditures to avoid depletion of the district's on-going unrestricted reserves.

The district's deficit spending is **not** within the established state standards for the current fiscal year and the two subsequent fiscal years. 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 two prior fiscal years and the projected change based on the First Interim Report and board approved multi-year financial projections for the 2010-11 through 2012-13 fiscal years.

CHANGE IN UNRESTRICTED FUND BALANCE TRENDS



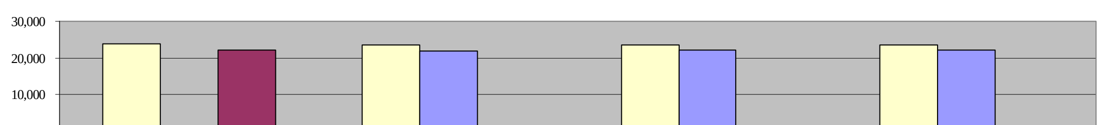
	2009-10 Actual	2010-11 1st Interim	2011-12 Projected	2012-13 Projected
Change in Unrestricted Fund Balance	(2,399,159)	(3,679,353)	(21,792,954)	(27,819,793)
Unrestricted Fund Balance	22,808,867	19,129,514	(2,663,440)	(30,483,233)

- **AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2010-11 K-12 P-2 ADA of 21,833.96 or a 1.43% decline over prior year P-2 ADA. Based on an enrollment projection of 23,422, the district is anticipating an attendance ratio of 93.22%. Additionally, the district is projecting a 0.92% increase in ADA for 2011-12 and a 0.49% increase in ADA for 2012-13. The district's three year average of ADA change has been a decrease of 1.09%. The state's standard is based on the average ratio of P-2 ADA to enrollment over the past three years.

  Based on the enrollment and ADA projections for the current and two subsequent fiscal years, the district is just over the state standard of 93.5% for the two subsequent fiscal years. The district does not appear to be projecting ADA at a reasonable level in the two subsequent fiscal years based on historical trends. However, the district has indicated that the growth is based on a newly implemented Saturday School and the opening of the new high school in 2011-12. 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.

  The following chart displays the district's actual P-2 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 monitor the correlation between enrollment and ADA closely.

COMPARISON OF ATTENDANCE TO ENROLLMENT TRENDS



	2009-10 Actual	2010-11 1st Interim	2011-12 Projected	2012-13 Projected
Enrollment	23,931	23,422	23,544	23,664
ADA Projections		21,834	22,034	22,142
Actual ADA ADA	22,151			
ADA/Enrollment Ratio Ratio	92.56%	93.22%	93.59%	93.57%

- **REVENUE AND EXPENDITURE PROJECTIONS** – Our review included an analysis of the district's projection of revenues and expenditures in the current and two subsequent fiscal years. The district's projection of current and subsequent state aid appears to be reasonable.

  The district is projecting a decline in current year ADA and is utilizing the state's prior year guarantee of ADA in the state aid revenue limit projections. The state allows districts to utilize the current or prior year P-2 district ADA whichever is higher to determine annual state aid revenue limit projections. Any ADA related to county operated programs or contracted programs such as Non Public School (NPS) are always funded on the current year reported annual attendance.

  The district has projected for one-time Federal ARRA and Education Jobs bill revenues received or deferred to the current fiscal year in the amount of $5,668,342. It appears that the district has adjusted the multiyear revenue projections to remove that funding in the subsequent fiscal years. The impact of the loss of this one time federal revenue is causing the district to move those restricted expenses for staffing costs to the unrestricted general fund causing increased deficit spending reducing the fund balance reserves.

- **ENDING CASH AND MONTHLY CASH FLOWS –** Due to the current State Budget including additional and ongoing deferrals of state revenues; change in apportionment distribution schedules; and ongoing state funding reductions, the monitoring and projection of monthly cash balances has become increasingly critical to ensure fiscal solvency. The deferral of state revenues and changes in distribution schedules by the state can cause a district's cash balances to be depleted, even if budget plans indicate a positive fund balance. Our review of the cash flow provided by the district indicates that the district will have a positive cash balance at the end of each month and at the end of the fiscal year by utilizing interfund borrowing crossing fiscal years. To maintain a positive cash position, the district is using inter-fund borrowing of $25 million which requires repayment by June 30, 2010, and a Constitutional Advance of $7,877,508 which requires repayment of 50% in December 2010 and 50% in April 2011. The board may take action within 120 days of the end of the fiscal year in order for the district to utilize interfund borrowing that crosses fiscal years. It appears from the cash flow projections provided by the district, that the intention is to continue to utilize interfund borrowing to meet fiscal year end cash needs, however as noted earlier the district needs to reduce ongoing expenditures in order to continue to maintain fiscal and cash solvency in future years. A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available.

- **STAFFING PROJECTIONS/SALARY SETTLEMENTS –** The district has indicated that negotiations have not been finalized with the certificated and classified bargaining units. The documents also indicate that the district is including step and column adjustments in the two subsequent fiscal years and providing for additional staffing increases to offset the ADA increases. It was also noted, as indicated above, that the district appears to be moving staffing costs from restricted to unrestricted in 2011-12 due to the loss of one time federal ARRA and Education Jobs bill revenues. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 4%, 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.

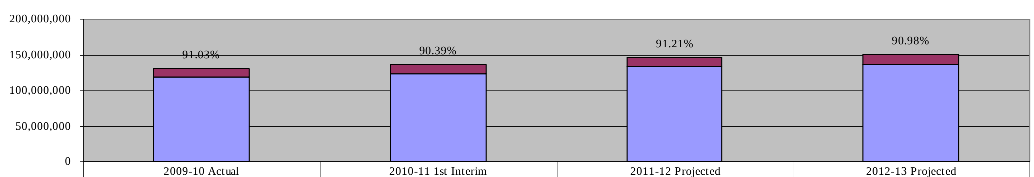
  Pursuant to AB1200/AB2756, please provide an analysis of the cost(s) or savings associated with any proposed or tentative agreement(s) or MOUs, including the impact on the current operating budget and multi-year financial projections, **<u>at least ten days prior to adoption by the board</u>**. Budget transfer documents implementing any 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**), under AB1200/AB2756 Salary disclosure. Instructions for completing these forms are also available on the website. These forms must be disclosed at a board meeting for all contract changes regardless of fiscal impact. This includes contract wording, non-work or furlough days, etc.

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, current year's First Interim 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. If salaries and benefits are changing 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 prior to staffing changes or entering into a collective bargaining agreement.

RATIO OF UNRESTRICTED SALARIES AND BENEFITS TO UNRESTRICTED EXPENDITURES



	2009-10 Actual	2010-11 1st Interim	2011-12 Projected	2012-13 Projected
Ratio Salaries & Benefits Sal./Ben. To Total Exp.	91.03%	90.39%	91.21%	90.98%
Total Other Unrestricted Expenditures Expenditures	11,760,490	13,130,711	12,846,625	13,581,754
Total Unrestricted Salaries and Benefits	119,352,206	123,464,842	133,257,781	136,929,507

- **MULTI-YEAR PROJECTIONS –** The district is projecting unrestricted reserves of 4.9% in 2010-11, 0.41% in 2011-12 and -13.68% in 2012-13. The district has indicated that the governing board plans to identify and approve a fiscal plan for implementation of expenditure reductions and/or revenue enhancements in January 2011, after the Governor's January Budget proposals are released. As indicated earlier, all expenditure reductions must be board approved and fully negotiated by the Second Interim Financial Reporting period in order to include them in the district's multi-year financial projections. The district has incorporated a 1.9% Cost of Living Adjustment (COLA) in the revenues for the 2012-13 fiscal year as recommended by School Services of California's (SSC) dartboard, but has not set aside any unrestricted reserves in the event that this COLA is not funded.

  Our office recommends that as the district's governing board is developing the fiscal action plan to meet ongoing district solvency in the current and two subsequent fiscal years, as identified earlier, that they also incorporate additional tiered levels of potential expenditure reductions as a contingency plan against the possibility of state COLAs not being funded in future years. This additional tiered level approach identifying and approving expenditure reductions as part of a fiscal plan will assist the district and governing board in meeting future potential revenue losses which may be identified in the Governor's January Budget proposals for 2011-12. This will also

help in determining the priority in meeting district education goals, if reduced funding levels are realized in future years.

- **LONG TERM DEBT** – The First Interim includes non-voter approved long-term debt of $18,461,406 which constitutes 10.09% of the district's projected general fund budget. The debt repayment is budgeted in the General, Child Development, and Capital Facilities Funds. The district should closely monitor the revenue stream of these funds to ensure that adequate revenues are received to provide for the current debt repayment schedule for principal and interest payments, and take appropriate action should revenues not materialize as anticipated.

If you have any questions concerning our review of the district's 2010-11 First Interim Financial Report, please contact the undersigned.

Sincerely,

Teri Kelly, for Cynna Hinkle

Cynna Hinkle, Business Services Advisor
Business Advisory Services
(909) 777-0761

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