EDUCATION: TOMORROW'S FUTURE
SAN BERNARDINO
COUNTY
SUPERINTENDENT OF
SCHOOLS
Gary S. Thomas, Ed.D., Superintendent

August 7, 2013

Jerry Almendarez
Superintendent
Colton Jt. Unified School District
1212 Valencia Dr.
Colton, CA 92324-1798

Dear Mr. Almendarez:

Thank you for the submission of the district's 2013-14 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. On June 27, 2013, the Governor signed the State Budget Act, AB 110, and on July 1, 2013 the accompanying trailer bills AB97 (K-12 Local Control Funding Formula (LCFF) and AB86 (K-14 education omnibus). The provisions of these bills, coupled with the advice contained in the Common Message – 2013-14 State Enacted Budget and Related Multi-year Projections, were used in our review.

Subsequent to the district's approval of the 2013-14 Adopted Budget, the funding structure for state aid allocations has changed dramatically with the passage of the AB97 Local Control Funding Formula (LCFF) trailer bill on July 1, 2013. Over the next few months, the education community must assess the budget impact of these changes on an individual basis. Our office will continue to provide guidance throughout this process. While our office has considered these changes during our budget review process, we anticipate reviewing the full impact of this change with the district's First Interim Financial Report due to our office on December 16, 2013.

The 2013-14 Adopted Budget of the **Colton-Joint Unified School District** has been reviewed and **Disapproved** pursuant to the provisions of Education Code Section 42127 (c)(d) as identified below:

As adopted by the district's Governing Board, the 2013-14 Adopted budget reflects an unrestricted ending balance reserve in the General Fund of only 3%. Although the district's reserve level remains stagnant at 3% in the 2012-13 Estimated Actuals to the 2013-14 Budget, the unrestricted ending fund balance decreased by $9.3M. Additionally, the district is projecting unrestricted ending fund balance reserves at a **-6.61%** in 2014-15 and at **-17.81%** in 2015-16. For fiscal years 2014-15 and 2015-16, the district projects **negative** unrestricted ending balances of approximately $12,327,728 and $34,769,801, respectively, leaving the district fiscally insolvent. During our review it was noted the district's projection of state aid revenue was overstated by approximately $512,805, in 2013-14, by $546,255 in 2014-15 and by $539,787 in 2015-16 due to the incorrect revenue offset for unemployment insurance.

Without including the effects of LCFF and excluding the overstated revenues, our analysis shows the district's ending fund balance reserves would be projected at **2.72%**, **-7.15%** and **-18.61%** in 2013-14, 2014-15 and 2015-16, respectively indicating the district does not meet the minimum required 3% reserves in the current and two subsequent years.

Our review of the district's cash balance projections also indicates that by June 2014, the district will have depleted available General Fund cash balances, without temporary borrowing. Currently, the district is utilizing a temporary inter-fund loan of $15M and Tax Revenue Anticipation Notes (TRAN) of $29,950,000 in order to meet cash obligations.

Our office cannot approve a district's budget without evidence that the board has approved specific reductions that allow the district to meet all fiscal obligations, as identified in the state's criteria and standards, in the current and two subsequent fiscal years, which is not evident in the Adopted Budget submitted.

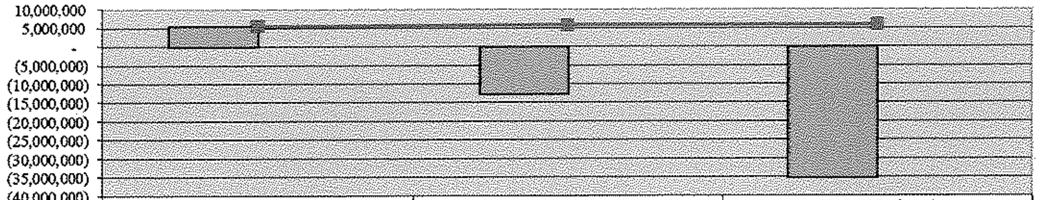
In order for our office to approve the district's Adopted Budget, we need to have evidence that the board has taken actions to approve a fiscal action plan for all three fiscal years that clearly identifies whether the board-approved reductions are one-time or ongoing, the fiscal year(s) in which the reductions will occur, and an estimated dollar amount of savings. Our office has considered the estimated LCFF funding in the current year and two subsequent fiscal years and the CSEA bargaining agreement savings in evaluating the amount of reductions that the district must make in order to be fiscally solvent. We have determined that the plan should include board-approved, ongoing reductions to the unrestricted general fund at a minimum of $1.6M in fiscal year 2014-15, plus an additional $15.7M for 2015-16 to meet the state minimum reserve standard of 3% for all fiscal years. **This additional information <u>must</u> be provided as part of the Revised Adopted Budget to be board approved and submitted to our office <u>no later than September 9, 2013</u>. Our office will not be able to Approve the 2013-14 Budget until all the following have been addressed:**

- **A realistic fiscal action plan for budget reductions has been approved by the governing board**
- **On-going deficit spending has been eliminated to demonstrate that the district's structural budget problem has been dealt with**
- **District can demonstrate a positive two year cash flow**
- **District can meet all fiscal obligations in the current and two subsequent fiscal years**

All budget adjustment for the 2013-14 fiscal year will need to be identified and included in the budget development system and re-rolled to tentative status prior to this date. Revised multiyear financial projections and assumptions must be included in the SACS2013 software and a new budget submission with all previously required supplemental forms submitted at that time. The district governing board will need to adopt the revised budget after holding a public hearing regarding the proposed revisions. This public hearing must be conducted pursuant to Education Code §42103.

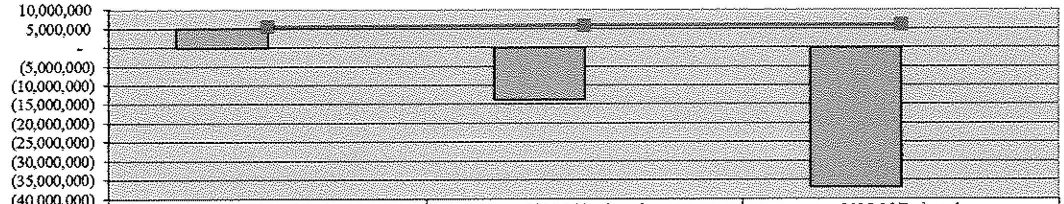
Under Education Code §42127(d), SBCSS may assign a fiscal adviser to assist the district with development of a budget in compliance with the above required revisions. We will be contacting the district chief business official to arrange this additional assistance, as needed. A summary of the disapproved budget process is attached for your review.

UNRESTRICTED FUND BALANCE RESERVES



	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
Available Unrestricted Reserves	5,523,286	(12,786,230)	(35,228,303)
Unrestricted Available Reserves %	3.0%	-6.61%	-17.81%
Minimum State Required Reserves	5,523,284	5,806,422	5,935,392

UNRESTRICTED FUND BALANCE RESERVES
(Excludes Overstated Revenue)



	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
Available Unrestricted Reserves	5,010,481	(13,845,290)	(36,827,150)
Unrestricted Available Reserves %	2.72%	-7.15%	-18.61%
Minimum State Required Reserves	5,523,284	5,806,422	5,935,392

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

- Unrestricted Deficit Spending Trends
- Average Daily Attendance (ADA) & Enrollment Projections
- Current and Multiyear Projections
- Negotiations Status/Salaries and Benefits Trends
- Long Term Debt
- Cash Flow
- Future Risks
- State Enacted Budget – 45 Day Revision

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:

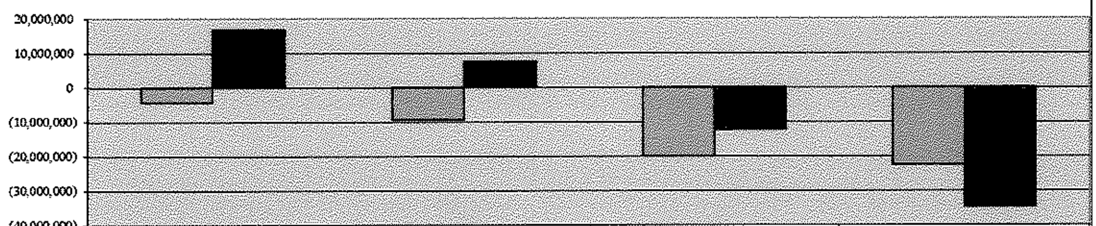
- **UNRESTRICTED DEFICIT SPENDING TRENDS** – As submitted, the district is projecting unrestricted expenditures to exceed unrestricted revenues by $9,360,272 in the current fiscal year, primarily due to expiration of classified negotiated concessions, deferred maintenance projects, one-time purchase of buses for special education and other operational costs. The district is continuing this trend of deficit spending in fiscal year 2014-15 by $19,875,601 and in fiscal year 2015-16 by $22,442,073. This ongoing trend of deficit spending is causing the district's unrestricted ending fund balances to drop to **-$12,327,728** in 2014-15 and to **-$34,769,801** in 2015-16 causing district insolvency. This ongoing and increasing deficit spending appears to be attributed to the expiration of negotiated concessions and ongoing operational costs offset by the increase of state aid primarily due to the COLA adjustment in both subsequent years. **It is imperative the district eliminate its trend of deficit spending in order to restore fiscal solvency.** Anticipated deficit spending should be for one-time, non-recurring expenditures to avoid depletion of the district's on-going unrestricted reserves. Ongoing deficit spending will cause an even greater reliance on district cash reserves.

The district did not include any funding increases pursuant to LCFF implementation. The funding increases projected may only offset a portion of the district's deficit spending shown on the district's Multiyear Projection (MYP). Once the district's budget is revised to include LCFF funding and any other changes that have occurred since the State Budget was enacted, it will be able to present a clearer picture of its financial position.

The district's deficit spending is **not** within the established state standards for the current and two subsequent fiscal years and substantially exceeds those standards in both subsequent fiscal years. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

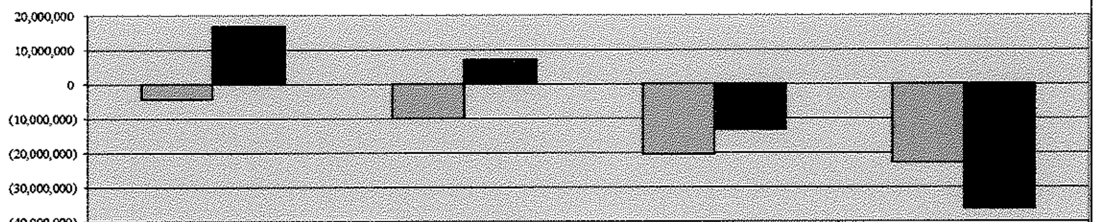
The following chart displays the actual Unrestricted General Fund balance change for the prior fiscal year, the projected adopted budget, and board approved multi-year financial projections reflecting the 2014-15 and 2015-16 fiscal years. The second chart displays the actual Unrestricted General Fund balance change for the prior fiscal year, the projected adopted budget, and board approved multi-year financial projections reflecting the 2014-15 and 2015-16 fiscal years excluding the overstated revenues in the budget year and two subsequent fiscal years.

CHANGE IN UNRESTRICTED FUND BALANCE TRENDS (DEFICIT SPENDING)



	2012-13 Estimated Actuals	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
Change in Unrestricted Fund Balance	(4,292,931)	(9,360,272)	(19,875,601)	(22,442,073)
Unrestricted Fund Balance	16,908,144	7,547,873	(12,327,728)	(34,769,801)

CHANGE IN UNRESTRICTED FUND BALANCE TRENDS (DEFICIT SPENDING)
(Excludes Overstated Revenues)



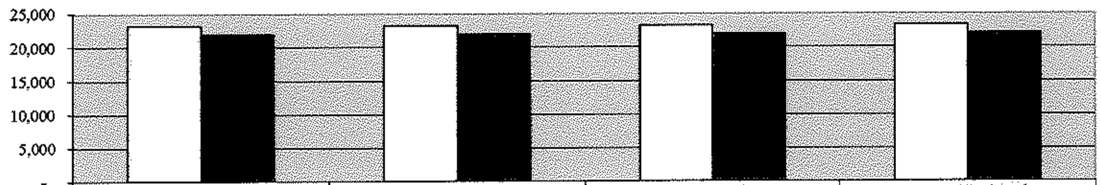
	2012-13 Estimated Actuals	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
Change in Unrestricted Fund Balance	(4,292,931)	(9,873,077)	(20,421,856)	(22,981,860)
Unrestricted Fund Balance	16,908,144	7,035,068	(13,386,788)	(36,368,648)

- **AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2013-14 P-2 ADA of 21,959 or a 0.13% increase over prior year P-2 ADA. The district's three-year average change in ADA has been a decline of 0.33%. Compared to the enrollment projection of 23,200, the district is anticipating an attendance ratio of 94.65% for the current year. The district is projecting a 0.22% increase in ADA for 2014-15 and a 0.23% increase in ADA for 2015-16, resulting in an attendance ratio of 94.64% and 94.61%, respectively.

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 within the state standard of 95.14% for each of those years. Although the district appears to be projecting ADA at a reasonable level based on state standards, we recommend that the district continue to monitor changes in attendance and enrollment closely. 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 reported ADA and enrollment in the 2012-13 fiscal year 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



	2012-13 Actual	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
□ Enrollment	23,191	23,200	23,255	23,314
■ Actual/Projected P-2 ADA	21,930	21,959	22,008	22,058
ADA/Enrollment Ratio	94.56%	94.65%	94.64%	94.61%

- **CURRENT AND MULTIYEAR 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, however as mentioned earlier, the revenues were overstated due to the incorrect revenue offset for unemployment insurance. The district has incorporated COLA adjustments in the 2014-15 and 2015-16 fiscal years as estimated by the School Services of California's (SSC) dartboard.

  As noted earlier, the district did not include revenues for anticipated LCFF implementation as recommended by our office since the 2013-14 State budget had not been enacted.

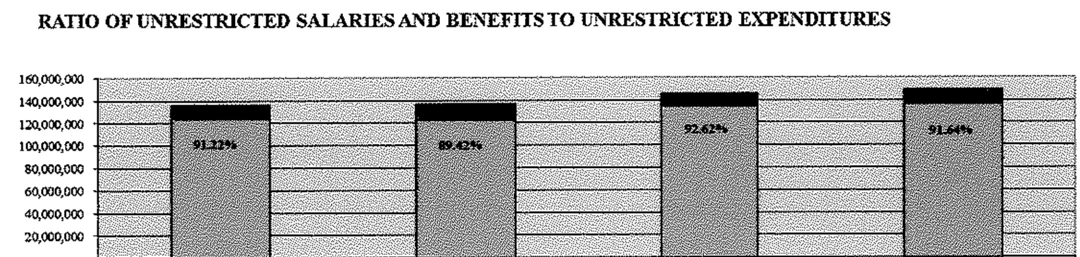
  Our review of the district's current and projected expenditures indicates approximately $7.3M of salary and benefit cost reductions were made in the 2013-14 as a result of continued concessions from the certificated and management employee groups. However, the projected savings of $1.9M from the classified negotiations was not included in the districts projected expenditures as these reductions were not Board approved until after the submission of the district's 2013-14 Adopted Budget. While these agreements do provide expenditure savings for 2013-14, they will expire on June 30, 2014 and do not provide an on-going expenditure reduction that can be reflected in the district's multi-year projections. The district is currently maintaining a 175-day school year. As required, the district's MYP reflects the restoration of the 7 furlough days which allows the district to meet the required restoration of a 180 day school year in the 2015-16 fiscal year.

- **NEGOTIATIONS STATUS/SALARIES AND BENEFITS TRENDS** – The information submitted with your Adopted Budget indicates that salary negotiations have been concluded for the 2013-14 fiscal year with the certificated and classified bargaining units. As indicated above, the classified agreement was not included in the Adopted Budget documents. The district will need to incorporate these savings with the submission of the revised budget on September 9, 2013. The documents also indicate that there are no other increases included in the adopted budget or subsequent fiscal years other than restoration of negotiated concessions and annual step and column advancements. Please keep us apprised of the status of the district's negotiations process for 2014-15.

Pursuant to AB 1200/2756 (GC 3540 et. seq.), please provide an analysis and disclosure of the costs or savings associated with any proposed or tentative agreements and/or Memoranda of Understanding (MOUs) **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 transfers implementing the adjustment(s) must also be posted in the financial system 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.

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 year, 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 for the current year, however 89.42% of unrestricted expenditures are being consumed by salary and benefit costs making unrestricted budget reductions difficult without negotiations. 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.

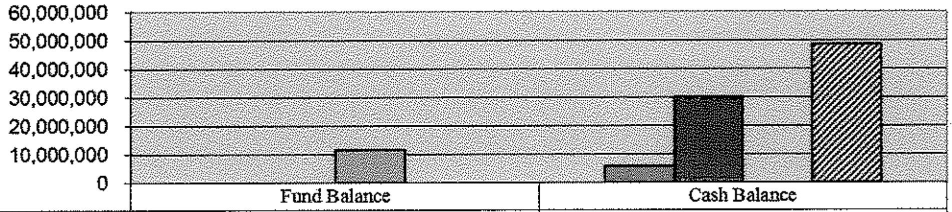


	2012-13 Estimated Actuals	2013-14 Adopted Budget	2014-15 Projected	2015-16 Projected
Ratio Salaries & Benefits	91.22%	89.42%	92.62%	91.64%
Total Other Unrestricted Expenditures	11,915,340	14,487,763	10,721,238	12,468,761
Total Unrestricted Salaries and Benefits	123,845,763	122,385,833	134,636,867	136,767,135

- **LONG TERM DEBT** – The Adopted Budget includes non-voter approved long-term debt of $19,123,692 which constitutes 10.39% of the district's general fund budget. The debt repayment is budgeted in the General, Child Development and Self-Insurance Funds. The district should monitor the revenue stream of these funds closely 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.

- **CASH FLOW**: Our review of the 2013-14 cash flow provided by the district, in conjunction with our internal cash analysis, indicates that the district will have a positive cash balance at the end of each month and at the end of the current fiscal year. The district's cash flow shows the June 30 cash balance is estimated to be 50.42% of the projected 2013-14 Ending Fund Balance including any cross-year temporary borrowing. To maintain a positive cash position, the district used cross-year Tax Revenue Anticipation Notes (TRAN) of $29,950,000 with set aside payments in June, July and August 2013 to be fully repaid on October 1, 2013. Additionally, to mitigate a negative cash position the district used inter-fund borrowing of $15M, which the district anticipates repaying in July 2013 and re-borrowing in May 2014. However, a review of the fund which is being used as the ongoing source for inter-fund borrowing may not have sufficient cash for the temporary borrowing. With cross-year temporary borrowing excluded, the district's cash balance would be **-$33,297,014.** Our review of the 2014-15 cash flow provided by the district indicates that the district will not have a positive cash balance at June 30, 2015.

COMPARISON OF FUND BALANCE AND CASH BALANCE



	Fund Balance	Cash Balance
June 30 Cash Balance		5,819,986
Cash Minus Temp. Borrowing		29,936,986
Ending Fund Balance	11,543,679	
Cash Balance Without Deferrals*		48,616,569

*Cash Balance Without Deferrals is informational only. Deferrals are included in Fund Balance but do not provide any actual cash until received in the next fiscal year.

Additionally, the district's revenue limit is computed to be 8.6% Property Taxes and 91.4% State Aid, which means your district will realize a greater loss of cash due to state deferrals than a higher property tax district. Our projections indicate that the state will defer approximately $18,344,388 of the district's 2013-14 state aid into the 2014-15 fiscal year. A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available.

- **FUTURE RISKS** - The 2013-14 State budget significantly changes the way school districts are funded. In addition, the State budget imposes a new set of accountability measures on districts while removing most restricted categorical programs along with their each individual compliance and accountability measures. This significant change brings with it risks. Some of the risks are continuous in nature, barring no future revisions of the law, while some may be short term in nature depending on how the changes will be implemented.

These risks are significant. A district's ability to mitigate these risks will depend on the flexibility that exists in its financial structure. If a district's financial structure is such that it has significant entanglement, meaning that it takes time to redirect financial resources, the greater the risk of fiscal insolvency.

The current risks that could have a significant impact on the District's fiscal wellbeing are as follows:

1. The new funding mechanism known as LCFF does not include any guarantees that districts will receive funding equivalent to the annual COLA.

2. The LCFF does not include any guarantees that future Legislatures/Governors will fund the LCFF at the proposed target level, or at any level of increase.

3. The rules regarding how districts must spend the supplemental and concentration grants have yet to be developed. At this time, the extent of any restrictions or flexibility in the use of these funds is unknown.
4. The full impact of Federal sequestration is unknown at this time. The estimate is that as of July 1, 2013, all programs will see a reduction of 5.23% from 2012 funding levels.

5. The elimination of the revenue limit as the funding mechanism removed certain expenditures protections.

   a. Under the revenue limit model, districts enjoyed a level of stability in the cost of CalPERS retirement premiums. The cost to an district could not exceed 13.2%. If CalPERS exceeded a rate of 13.2%, the State picked up the difference. If the CalPERS rate was less than 13.2%, the State captured the difference. With the implementation of the LCFF, that protection no longer exists. Districts will now be responsible for the entire costs of CalPERS retirement premiums whether they increase or decrease. Given the adjustments to the CalPERS fund's asset smoothing and amortization methods aimed at improving the funded status of the retirement program, districts can expect significant increase retirement premiums in the future.

   b. The revenue limit model protected districts from fluctuations in the Unemployment Insurance contribution rates. All districts were held at their 1975-76 actual Unemployment Expenditures. This protection no longer applies in the LCFF model. All increases in the Unemployment Insurance contribution rate since 1975-76 immediately impacts the District, including any increases in future years. In addition, districts will experience constant fluctuation in their expenditures as the rate increases and decreases in future years.

6. At this time, the cost impact of the Affordable Care Act (ACA) is still unknown. As the Federal Government continues to work out the regulations attached to the law more information and the ability to determine current and future costs will be possible. Currently, the survival of the law is uncertain. What is known at this time is that the reform has not bent the cost curve downwards as it was projected it would. Instead, premiums have increased significantly and it we anticipate that they will continue to sharply increase in the future. If the law survives, these future costs will be borne by the District, regardless of whether the District receives any increase in funding under the LCFF, or not.

7. According to CalSTRS, in order to fund fully the retirement program within thirty years, additional contributions of 17.2% will be required. CalSTRS and the Legislative Analyst Office (LAO) are urging the Legislature to enact a funding plan by the end of the 2014 legislative session. If that occurs, districts will start seeing an increase in their CalSTRS premium costs starting in 2014-15.

- **STATE ENACTED BUDGET – 45 DAY REVISION** – Our review has been based on the latest information available to this office with the 2013-14 State Enacted Budget. Please remember that Education Code § 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".*

The 45-day period ends August 12, 2013. We will require these revisions to be included in the 2013-14 Revised Budget submission, including a narrative of the changes made.

CONCLUSION - We are all breathing a sigh of relief in this first year where we are experiencing new revenues instead of revenue cuts. While we are all eager to begin restoring those programs that took a hit in these past years of revenue cuts, we must still be cautious. While the passage of Proposition 30 brought good news to the public, we in K-12 schools know that in reality the financial picture and outlook remain tenuous.

These remain difficult economic times as any recovery has been slow, and the outlook on continual growth is not necessarily optimistic. Adding to the slow economic recovery are the unknowns as listed in the future risk section of this letter. Consider that two of the big reforms, LCFF and ACA, of our time remain unfinished as the task of finalizing the details have been delegated to the bureaucracies. With so much of our expenditure components remaining undefined, these remain extraordinarily tough times to plan our future finances in a manner that is prudent and responsible. Therefore, it is important during these times that school districts stay proactive and cautious by developing budgets and contingency plans that allow the most flexibility in resource allocation as possible so that they can quickly react to unexpected decreases in revenues and/or unexpected increases in expenditures.

We anticipate a timely year-end closing of the 2012-13 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 2013-14 and audited ending balances for 2012-13. These actions will also ultimately affect the availability of reserves for the 2013-14 operating budgets. The audit report is due on or before December 16, 2013.

Any questions concerning the review of the district's 2013-14 Adopted Budget may be addressed to me at (909) 386-9678.

Sincerely,

Cynna Hinkle

Cynna Hinkle, Director
Business Advisory Services

CH:ls

Attachment: Disapproved Budget Process

cc: Tom Torlakson, Superintendent of Public Instruction
Peter Foggiato, Director, School Fiscal Services Division, California Department of Education
Dr. Gary Thomas, San Bernardino County Superintendent of Schools
Ted Alejandre, Assistant Superintendent of Business
Lisa Regalado, Business Services Advisor-SBCSS

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Disapproved Budget Process