April 7, 2011

Mr. Jaime R. Ayala, Assistant Superintendent Business Services
Colton Jt. Unified School District
1212 Valencia Dr.
Colton, CA 92324-1798

Dear Mr. Ayala:

Thank you for the submission of the **Colton Joint Unified School District** 2010-11 Second 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 standard of 3% in the 2012-13 fiscal year and is projecting substantial deficit spending in both 2011-12 and 2012-13. Additionally, while the district board has approved Budget Reduction Resolution No. 10-024 and 11-03, the district has not submitted a sufficient fiscal action plan outlining approved budget reductions required to meet the state minimum reserve standard in all fiscal years. While the district has taken steps to reduce this deficit with board authorized reductions in the current fiscal year, sufficient reductions have not yet been approved to meet the 2012-13 fiscal year reserve levels. Additionally, our review of district General Fund cash indicates that without inter-fund temporary borrowing of $25M, the district would not have sufficient cash balances to cover all anticipated expenditures through June 30, 2011 and into the 2011-12 fiscal year. While the district does have current inter-fund temporary cash borrowing options for the current fiscal year, those funds could be depleted before the last months of 2011-12, requiring the district to borrow from outside financial sources at an additional cost to the district. Based on our analysis, the data provided supports the board's ***Self-Qualified certification*** of the district's financial condition which indicates that the district may not be able to meet all financial obligations in the current or subsequent two fiscal years.

We commend the district and board for self-qualifying and continuing to take the necessary steps to maintain ongoing fiscal solvency. Under E.C. 42127.6(a)(1), our office will continue to provide the district with the services of Michele McClowery, as a fiscal expert to assist the district and board to develop and approve a fiscal action plan that will enable the district to meet both cash and other fiscal obligations through 2013-14.

Under E.C. 42131(e), if a district has a qualified or negative second interim certification the district is required to submit an End of Year Financial Report to our office no later than June 1, 2011, utilizing actual financial data through April 30, 2011 and projections through June 30, 2011. This report should include any further progress regarding the implementation of expenditure reductions

involving negotiable items. The End of Year Financial Report should serve as the basis for the 2010-11 Estimated Actuals used for the 2011-12 District Adopted Budget and the updated multiyear financial projections should closely reflect the current projections to be included in the district's 2011-12 Adopted Budget. These projections should include any assumptions that become known with the Governor's May Budget Revision proposals.

Under E.C. 42127.6(a) (1), our office is requiring the district take the following actions as part of the June 1, 2011 End of Year Financial Report:

- **Submit a financial projection of all fund balances as of June 30, 2011 (utilizing the SACS 2010All software, end of year projection reporting period). (EC 42127.6(a)(1)(C))**
- **Submit a financial projection of General Fund balances, unrestricted, restricted and combined for the two subsequent fiscal years (utilizing the SACS software, Form MYP) (EC 42127.6(a)(1)(C))**
- **Submit a financial projection of monthly cash balances through June 30, 2011 and for the 2011-12 fiscal year. (EC 42127.6(a) (1) (C)) and include any board actions regarding the district's plans for temporary borrowing in either year.**
- **Submit a fiscal action plan covering the planned reductions to be included in the 2011-12 and 2012-13 fiscal years, including assumptions and details regarding whether reductions or additional revenues are one time or ongoing and what items are subject to pending negotiations. The assumptions should be itemized, quantified, and address how the district is planning to rebuild the General Fund ending balance and reserve levels over the next two years (EC 42127.6(a)(1)(E)**
- **Submit an updated Form ADA and Form RL for the current and two subsequent fiscal years.**
- **Submit a projection of ending cash balances for all district funds as of June 30, 2011 to determine potential temporary borrowing options.**

The Office of the San Bernardino County Superintendent of Schools has reviewed the Second Interim Financial Report submitted for the period ending **January 31, 2011**. Our review included an assessment and analysis of the following major components of the district's report:

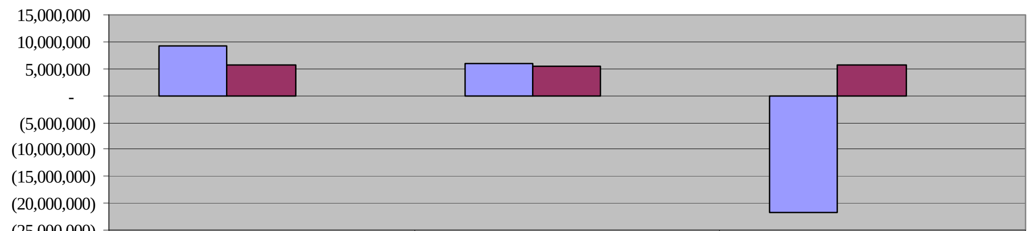
- Unrestricted Ending Fund Balance and State Minimum Reserve
- Unrestricted Deficit Spending
- Average Daily Attendance (ADA) & Enrollment Projections
- Revenue and Expenditure Projections
- Ending cash positions and Monthly cash flows
- Staffing Projections/Salary Settlements
- Multi-year Financial Projections
- Long Term Debt
- Other Funds

The Second 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 ENDING FUND BALANCE AND STATE MINIMUM RESERVES –** As certified by the district's Governing Board, the Second Interim Financial Report projects an unrestricted ending balance reserve in the General Fund of 4.9%. The district is projecting unrestricted ending fund balance reserves at 3.2% in 2011-12 and at **-11.4% in 2012-13**, leaving the district fiscally insolvent within 2012-13.

For fiscal year 2012-13, the district does not meet the minimum state reserve standard. While the district has submitted Resolution No. 10-24 and 11-03 identifying the board's commitment to ongoing budget reduction, we have not received a specific fiscal action plan addressing the shortfall.. As part of the submission of the End of Year Financial Report and the 2011-12 Adopted Budget, the district will be required to submit a fiscal action plan that has been approved by the Governing Board. The fiscal action plan must state whether 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.

UNRESTRICTED FUND BALANCE RESERVES



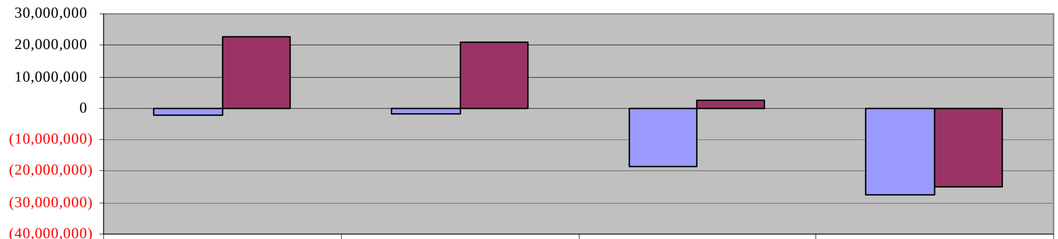
	2010-11 Projected	2011-12 Projected	2012-13 Projected
Available Reserves	9,307,225	5,918,267	(21,644,266)
Minimum State Required Reserves	5,682,943	5,518,657	5,709,763
Unrestricted Available Reserves %	4.9%	3.2%	-11.4%

- **UNRESTRICTED DEFICIT SPENDING –** The district is projecting expenditures to exceed revenues by $1,927,081 in the current fiscal year, primarily due to ongoing operational costs. The district is continuing this trend of deficit spending in fiscal year 2011-12 by $18,419,325 and in fiscal year 2012-13 by $27,617,370. This ongoing and significantly increasing deficit spending appears to be attributed to the end of the use of the one time federal funds, reduced state funding and ongoing operational costs. This significant level of deficit spending is causing the district to deplete all unrestricted reserves leaving the district fiscally insolvent within the 2012-13 fiscal year. With this level of ongoing deficit spending, the district needs to make immediate reductions within the 2011-12 fiscal year in order to reasonably make the level of ongoing reductions needed to retain fiscal solvency in 2012-13. This level of deficit spending will also compromise the district's availability of sufficient cash reserves given the state's increasing 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 two subsequent fiscal years. The State's established standard is one-third (1/3) of the district's available unrestricted reserve.

The following chart displays the actual Unrestricted General Fund balance change for the previous fiscal year and the projected change based on the Second Interim Report and board approved multi-year financial projections for the 2010-11 through 2012-13 fiscal years.

CHANGE IN UNRESTRICTED FUND BALANCE TRENDS



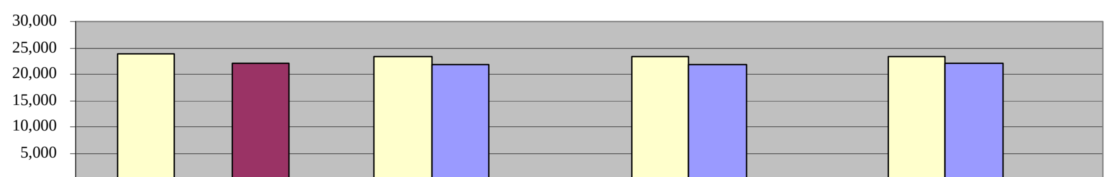
	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected	2012-13 Projected
Change in Unrestricted Fund Balance	(2,399,159)	(1,927,081)	(18,419,325)	(27,617,370)
Unrestricted Fund Balance	22,808,867	20,881,786	2,462,461	(25,154,909)

- **AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2010-11 K-12 P-2 ADA of 21,834 representing a 1.44% 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 0.16% growth in ADA for 2011-12 and a 0.61% growth in ADA for 2012-13, which equates to growth of 168 ADA over the next two years. The district's historic trend has been a decrease of 1.09% in ADA over the past three years, so the increased growth in the two subsequent years may be optimistic. The district has implemented a Saturday School program to increase current year ADA and has plans to open new school sites in the 2012-13 fiscal year. Our recommendation is not to project for ongoing ADA increases for these reasons until the district has seen some actual accountable data as this increase over projects available state revenues, which will not materialize if this increase is not realized. This could result in additional expenditure reductions in future years.

  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 slightly over the state standard of 93.47% for each of those years. As mentioned above, 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 previous 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



	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected	2012-13 Projected
Enrollment	23,931	23,422	23,310	23,457
ADA Projections		21,834	21,869	22,002
Actual ADA	22,151			
ADA/Enrollment Ratio	92.56%	93.22%	93.82%	93.80%

- **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 for the current and 2012-13 fiscal year, however the district may have overstated fundable ADA in the 2011-12 fiscal year by 249 ADA equating to $1.4M in increased revenue which may not materialize. The district is projecting for funded ADA of 22,173; however our analysis indicates that based on the ADA reported above of 21,869 and County ADA estimated to continue at 55, the funded ADA for 2011-12 would be 21,924. Our office recommends that the district closely review your ADA projections for purposes of state aid calculations and staffing needs.

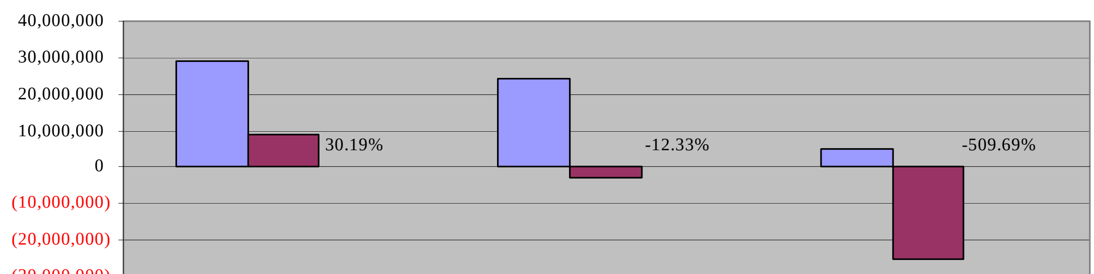
  The district is projecting a decline in current year ADA and is utilizing the state's prior year guarantee of ADA in the state aid revenue limit projections. The state allows districts to utilize the current or prior year P-2 district ADA (minus any loss of ADA to district sponsored charter schools), 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 is not utilizing this prior year guarantee in 2011-12, as the ADA is projected to increase slightly.

  The district is utilizing the majority of the one-time federal funds related to ARRA and the Education Jobs bill to meet current year operational needs of the district. The district has projected for one-time Federal Stimulus and Education Jobs revenues received in or deferred to the current fiscal year in the amount of $5.9M. It appears that the district has adjusted the multiyear revenue projections to remove this funding in the 2011-12 fiscal year. The district does anticipate that $1,059,292 of the 2010-11 restricted ending fund balance is the Federal Stimulus School Fiscal Stabilization funds to be utilized prior to September 30, 2011, for ongoing operating costs. This amount is removed from the subsequent fiscal years restricted ending balance reserves. The remaining restricted ending balance consists of Economic Impact Aid (EIA), MAA and LEA Medi-Cal funds.

  Our review of the district current and projected expenditures indicates that the district has reflected $307,955 of net reductions in salary and benefit costs in the 2011-12 fiscal year, however in the 2012-13 fiscal year salary and benefit costs are increasing by $5,170,652 due to additional new school staffing, health benefit increases and Step/Column adjustments. The district assumptions indicate that on March 3, 2011, the board approved a resolution for 79.11 FTE in certificated reduction in services. This could equate to a savings of $6M in each subsequent year if the board acts to implement in May 2011. Currently these additional savings are not yet included in the projections provided under direction of our office until a full fiscal action plan is approved and implemented by the governing board. Past practice indicates that these reductions have not always been fully implemented. Even with these potential reductions in certificated service savings, the district's 2012-13 unrestricted ending fund balance will be approximately $-13,154,909 without additional ongoing expenditure reductions.

- **ENDING CASH POSITION 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 have 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. We have expanded our review to include the first subsequent fiscal year in an effort to assist districts in identifying potential cash shortfalls in the future. 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 current fiscal year. The district's cash flow reflects the June 30 cash balance as 89.90% of the projected 2010-11 Ending Fund Balance, including a $25M temporary inter-fund loan anticipated to be transferred in May 2011. The actual June 30 General Fund cash balance without this inter-fund temporary loan is -12.33% of the anticipated June fund balance. The district's revenue limit is computed to be 6.60% Property Taxes and 93.40% State Aid which means your district will realize a greater loss of cash due to state deferrals than a higher property tax district. As indicated earlier, our review of the cash flow provided by the district indicates that the district will not have sufficient cash starting in May 2011, unless further expenditure reductions; revenue enhancements or temporary borrowing is implemented. To maintain a positive cash position throughout the past fiscal year, the district utilized a Constitutional Advance on property taxes of $7,877,508 which was repaid 50% in December 2010 and the balance to be repaid in April 2011. Additionally, the district used inter-fund borrowing of $19M from October 2010 through March 2011. Our office has also reviewed a projected cash flow prepared by our office for the first subsequent fiscal year to determine if the July 2011 cash balance is sufficient to support July expenses, if no state revenues are received. Our projections indicate that while the district should have sufficient cash in July 2011 due to the above mentioned planned inter-fund temporary loan of $25M, the district will have to repay this loan by the end of June 2012. Before the end of June 2012, the district will need to implement another temporary cash borrowing loan through inter-fund transfer or a mid-year Tax Revenue Anticipation Note. Please see Bulletin #11-078 for more information on temporary cash loan processes. The charts listed below show the district's projected cash as of June 30, 2011 with and without the $25M anticipated temporary inter-fund loan, and our projection of cash by June 30, 2012 without any further cash borrowing. A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available.

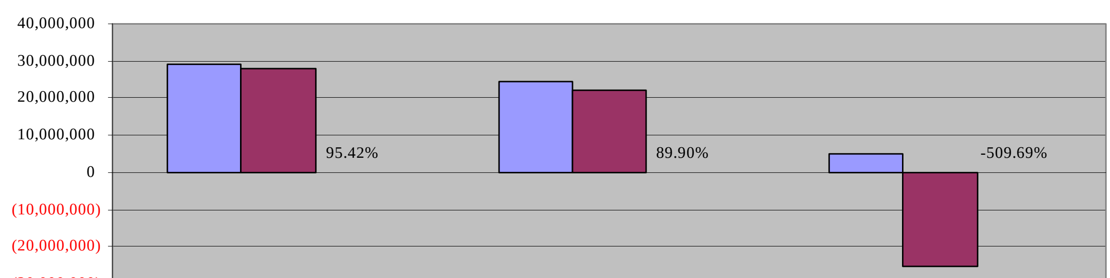
RATIO OF ENDING CASH BALANCE TO ENDING FUND BALANCE



	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected*
Ending Fund Balance	29,126,263	24,454,236	4,975,619
Ending Cash Balance**	8,792,767	(3,016,182)	(25,360,132)
Ratio Cash to Fund Balance	30.19%	-12.33%	-509.69%

***2011-12 Ending Cash Balance projected by BAS staff**
**** Cash Balances are reflected without interfund temporary loans of $19M in 2009-10 and $25M in 2010-11 .**

RATIO OF ENDING CASH BALANCE TO ENDING FUND BALANCE



	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected*
Ending Fund Balance	29,126,263	24,454,236	4,975,619
Ending Cash Balance**	27,792,767	21,983,818	(25,360,132)
Ratio Cash to Fund Balance	95.42%	89.90%	-509.69%

- **STAFFING PROJECTIONS/SALARY SETTLEMENTS –** The district has indicated that negotiations have not been finalized with the certificated and classified bargaining units for 2010-11. While the district had approved furlough days and reduction in certificated services for 2010-11, those were later rescinded by the board and the district used one time state and federal funds and carryover balances to meet current year fiscal obligations.

  The district has included board approved anticipated savings in the two future years, however some of those savings are offset by anticipated step and column adjustments for all affected staff and an anticipated increase of 7% in health benefit premium costs. The governing board approved in January through March 2011, salary and benefit savings totaling $4,024,664 consisting of 14 management furlough days, reduction of teacher substitute rate, 20% reduction in site and department budgets, reduction of Tier III funding to sites by 20%, elimination of substitute custodians, crossing guards, staff development, clerical, summer school, magnet program, GATE, school resource officers, adult education, cal-safe, and elementary coaching, along with a reduction to some athletic programs. Additionally, as noted earlier, 79.11 FTE of certificated reduction in services were approved by board resolution in March 2011. These potential reductions equate to a savings estimated at $6M for each of the two future years which will be incorporated into the fiscal action plan to be approved with the 2010-11End of Year Report and 2011-12 Adopted Budget. Even with these reductions, the district would still need additional expenditure reductions to maintain fiscal solvency by 2012-13 as mentioned earlier.

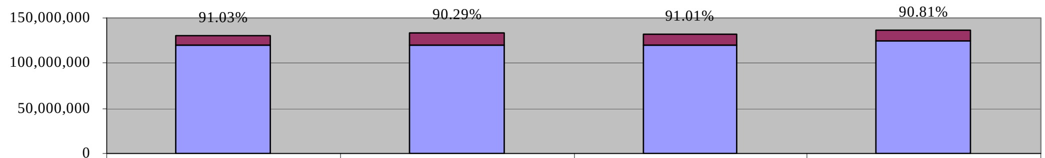
  Pursuant to G.C. 3547.5 and 3540.2, an analysis and disclosure of the costs or savings associated with any proposed or tentative agreement(s), or MOUs including the impact on the current operating budget and multi-year financial projections must be disclosed to the public and board action taken regardless of dollar value or lack of cost. This analysis should be provided to our office **at least ten days prior to adoption by the board**. 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 (E.C. 42142). 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 completed and disclosures taken to the board for all contract changes regardless of fiscal impact. This includes contract wording, furlough or non-work 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 previous fiscal year, current year's Second 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 growing at a faster rate 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. With the ongoing state revenue deferrals, a district with a substantially high salary and benefit ratio will need to maintain a higher reserve level to meet end-of-year cash needs associated with payables. 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

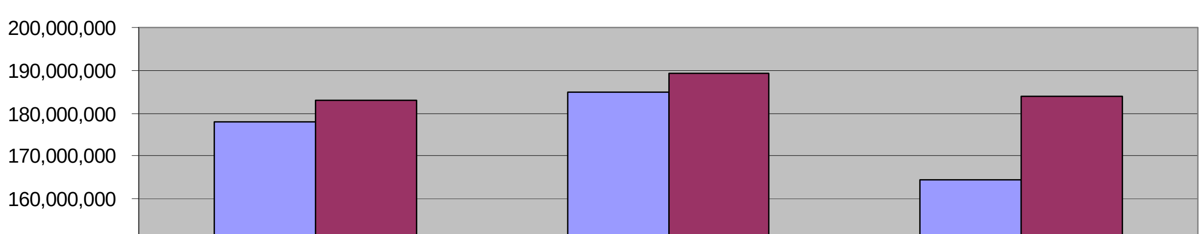


	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected	2012-13 Projected
Ratio Salaries & Benefits	91.03%	90.29%	91.01%	90.81%
Total Other Unrestricted Expenditures	11,760,490	12,966,841	11,907,084	12,556,570
Total Unrestricted Salaries and Benefits	119,352,206	120,530,438	120,609,061	124,029,413

- **MULTI-YEAR FINANCIAL PROJECTIONS –** The district is not projecting to meet minimum state reserves in all fiscal years. The district is projecting reserves of 4.9% in 2010-11, 3.2% in 2011-12 and -11.4% in 2012-13. The district has incorporated $4,024,664 in budget reductions that were approved by the governing board during January through March 2011 in the projections for the current and two subsequent fiscal years. Additionally, the district board has approved reduction in certificated services equating to 79.11 FTE, which could result in an additional $6M in savings in 2011-12 and 2012-13 which have not yet been included in these calculations as the board has not taken definitive actions to implement these reductions until May 2011. In the past, the board has not always approved the full implementation of these reduction notices and the district is still involved in negotiations which could affect the fiscal outcome of this level of reductions. Even with these additional potential reductions the district's 2012-13 unrestricted fund balance is still negative. The district has included the $349 per ADA ongoing state revenue reduction in the event the governor's temporary tax extension is not approved. Additionally, the district has incorporated a 1.8% Cost of Living Adjustment (COLA) in the 2012-13 fiscal year as indicated 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. The district has not yet submitted a complete fiscal action plan to our office identifying the balance of the reductions to be implemented in order to maintain fiscal solvency through 2012-13. The district is still relying heavily on one time solutions to meet ongoing expenditure needs causing the district to accumulate a substantially increasing level of deficit spending in 2011-12 and 2012-13. The district needs to make reductions starting in 2011-12 in order to reasonably meet and maintain ongoing fiscal solvency.

Our office recommends that the district be proactive by developing multiple contingency plans in response to the current state economy. If the temporary tax extension proposed in the Governor's January budget proposal is not approved by the electorate, additional expenditure reductions in addition to those currently represented may need to be implemented.

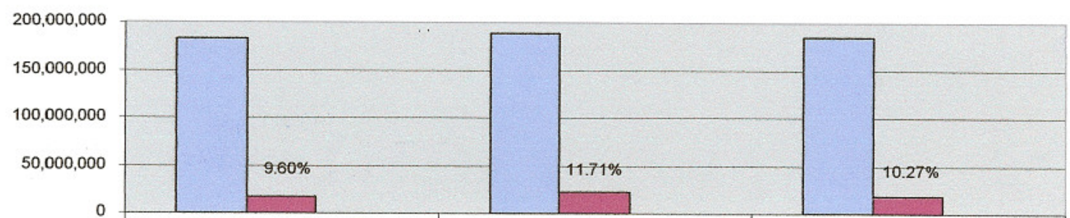
MULTIYEAR PROJECTION REVENUES AND EXPENDITURES



	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected
Revenues	177,877,406	184,759,422	164,476,619
Expenditures	182,896,145	189,431,449	183,955,236

- **LONG TERM DEBT** – The Second Interim Financial Report includes non-voter approved long-term debt of $22,191,605 which constitutes 11.71% of the district's projected general fund budget. The debt repayment is budgeted in the General, Child Development and Capital Project Funds for capital leases, certificates of participation, supplemental early retirement programs and compensated absences. 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. **It is recommended that a district with a debt ratio greater than 25% increase its minimum unrestricted reserve levels to twice the state standard to ensure funds will be available to meet the repayment obligations.**

DEBT AS A PERCENTAGE OF GENERAL FUND EXPENDITURES



	2009-10 Actual	2010-11 2nd Interim	2011-12 Projected
General Fund Expenditures	182,896,145	189,431,449	183,955,236
Non-Voter Approved Debt	17,553,455	22,191,605	18,898,095
Ratio of Debt to GF Expenditures	9.60%	11.71%	10.27%

- **OTHER FUNDS** – The district has utilized an inter-fund transfer of $5.4M in 2010-11 from the Special Reserve for Capital Outlay Fund (Fund 40) to the General Fund to meet ongoing operational needs. Additionally, the district is projecting to utilize $3.5M in 2011-12 from the Self-Insurance Fund (Fund 67) from funds set aside to meet future retiree benefit costs to meet ongoing General Fund operational needs, along with a reduction in the workers compensation rate and suspension of any general fund contribution to the Self Insurance Fund. Also noted was the district's reduction to the routine repair and maintenance (RRMA) account continuing from 2008-09 and the suspension of any general fund contribution to the Deferred Maintenance Fund in 2011-12 and 2012-13. This reduction in costs associated with ongoing facility repair and maintenance should be closely monitored to avoid any unforeseen facility emergency needs. The district is continuing to deplete balances in other district funds which reduces the ability for inter-fund borrowing for cash flow needs. These are also short term solutions to a long term problem.

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

Sincerely,

Teri Kelly, Director
Business Advisory Services
(909) 777-0761

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