

April 13, 2012

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 2011-12 Second Interim Financial Report**. We recognize the district's efforts in the development of a financial plan that provides for the ongoing financial stability of the district in these tough economic times.

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 3% state minimum reserve standard in the 2013-14 fiscal year. Based on our analysis, the data provided supports the board's *Self-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.

Under E.C. 42131(e), if a district has a qualified or negative second interim financial report certification, the district is required to submit an End of Year Financial Report to our office no later than June 1, 2012, utilizing actual financial data through April 30, 2012 and projections through June 30, 2012. 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 2011-12 Estimated Actuals used for the 2012-13 District Adopted Budget. The updated multiyear financial projections should closely reflect the current projections to be included in the district's 2012-13 Adopted Budget projections. 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 directing the district to take the following actions as part of the June 1, 2012 End of Year Financial Report:

- Submit a financial projection of all fund balances as of June 30, 2012 (utilizing the SACS 2011All 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, 2012 and for the 2012-13 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 or fiscal recovery plan covering the planned reductions to be included in the 2012-13 and 2013-14 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 other district funds as of June 30, 2012 to determine potential temporary borrowing options.**
- **Additionally, our office will continue to provide the services of a fiscal advisor utilizing our Business Advisory Services assigned Business Advisor, Cynna Hinkle, along with the services of Michelle McClowery, on an as needed basis to assist the district with the development and implementation of an ongoing fiscal action plan.**

Our review included an assessment and analysis of the following major components of the district's report:

- Ending Cash Position and Monthly Cash Projections
- Current and Multiyear Unrestricted Reserve Levels
- Unrestricted Deficit Spending Trends
- Average Daily Attendance (ADA) & Enrollment Projections
- Current and Multiyear Projections
- Negotiations Status and Salary and Benefit Trends
- Long Term Debt
- Ongoing Implications

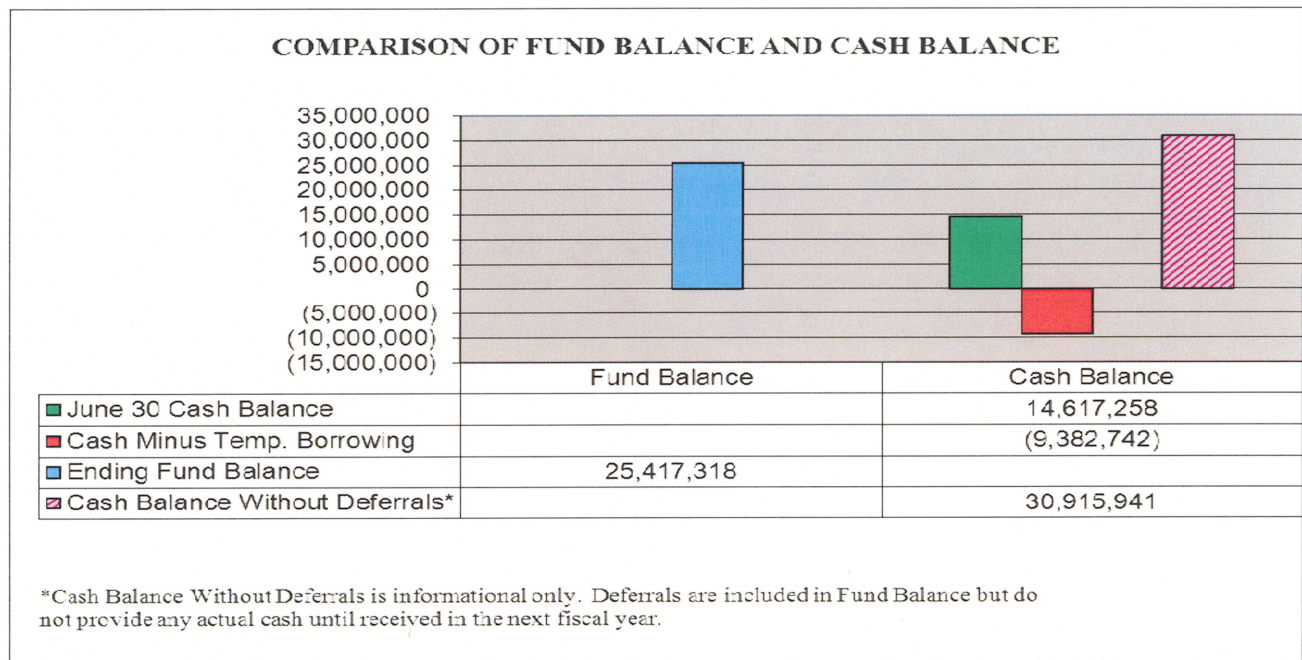
The Second Interim Financial Report provides the Governing Board with the opportunity to revise and review its operating budget plan based on the most recent State Budget information and local decisions made since the First Interim Financial Report. This plan should incorporate any updated revenue projections and utilization of expenditures to meet the goals and financial obligations of the school district in the current and 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:

- **ENDING CASH POSITION AND MONTHLY CASH PROJECTIONS** – Due to the current State Budget including significant deferrals of state revenues, changes 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.

Our review of the 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 after utilization of temporary borrowing. To maintain a positive cash position, the district used inter-fund borrowing, Tax Revenue Anticipation Notes (TRANs), and a Constitutional Advance totaling \$30,193,885 which was partially repaid on September, December of 2011, and March 2012 and requires final repayment by August 2012. Without including cross fiscal year TRANs borrowing of \$24 million, the district's cash balance is depleted to -36.91% of the projected 2011-12 Ending Fund Balance.

Additionally, the district's revenue limit is computed to be 8.95% Property Taxes and 91.05% State Aid, which means your district will realize a greater loss of cash due to state deferrals than a higher property tax district. This means that ongoing deficit spending will deplete current cash resources more quickly than a district with more locally received revenues and a higher fund balance reserve is needed to ensure sufficient cash resources are available for daily cash needs. Currently the state is deferring approximately \$40,298,683 of the district's 2011-12 state aid into the 2012-13 fiscal year.

The chart below reflects the district's cash situation based on our internal cash analysis. A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available.



- CURRENT AND MULTIYEAR UNRESTRICTED RESERVE LEVELS** – As certified by the district's Governing Board, the Second Interim Financial Report projects an unrestricted ending balance reserve in the General Fund of 3%. The district is projecting unrestricted ending fund balance reserves of 3% in 2012-13 and depletion to -2.48% in 2013-14 leaving the district fiscally insolvent.

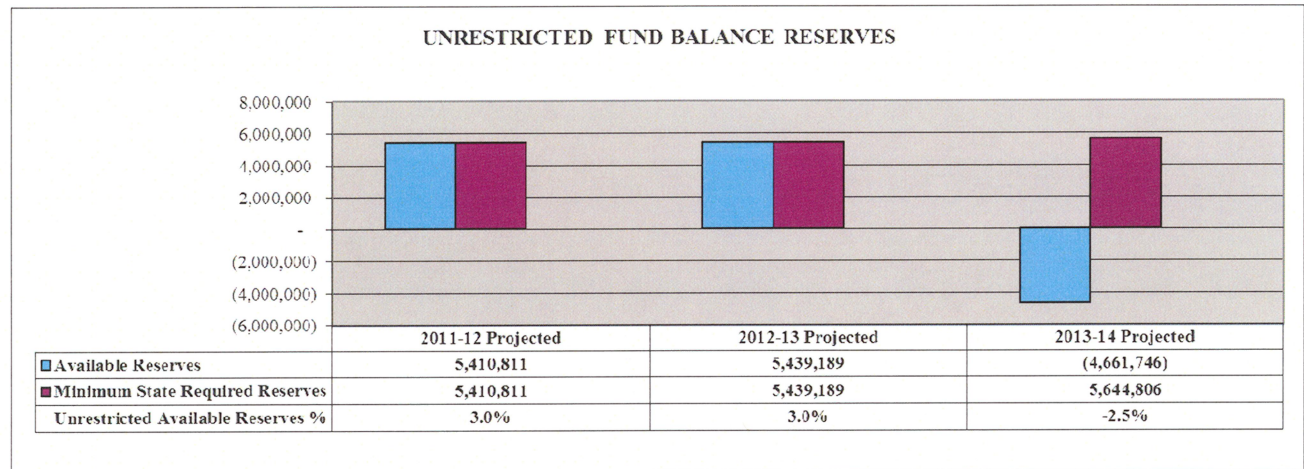
The district is **not** projecting to meet minimum state reserves in the 2013-14 fiscal year. The district has implemented approximately \$8,791,716 in budget reductions in fiscal year 2011-12. Additionally, the district has incorporated \$450,000 in program reductions, \$5.7 million in certificated negotiated salary and benefit reductions and \$790,146 in management furloughs for the 2012-13 fiscal year.

As part of the submission of the End of Year Financial Report and the 2012-13 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 needed to bring the district fiscally solvent in all years.

The district Governing Board has approved a resolution identifying an amount of potential expenditure reductions and/or revenue enhancements for the 2013-14 fiscal year, but still needs to approve and

identify the specific action plan components as part of the 2012-13 Adopted Budget process. The fiscal action plan must identify the expenditure reductions or revenue enhancements as one time or ongoing; for which fiscal year the reductions/enhancements will occur; if the reductions need to be negotiated with the bargaining units; and an estimated dollar amount of savings for each fiscal year.

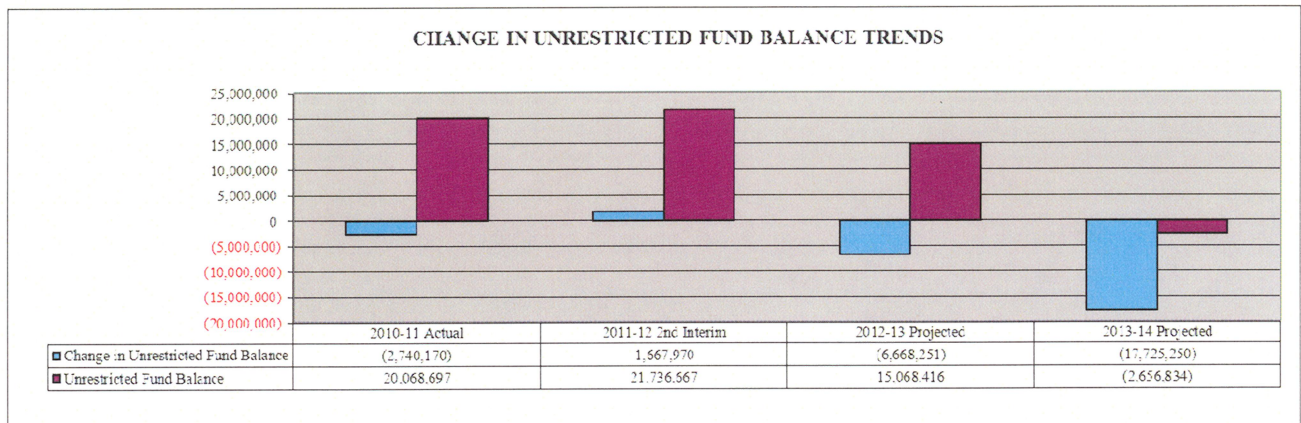
Our office recommends that the district be proactive by developing contingency plans in response to the current state economic forecasts and ever-changing budget proposals.



- UNRESTRICTED DEFICIT SPENDING TRENDS** – The district is not projecting to deficit spend in the current fiscal year, primarily due to the negotiated settlement with the certificated and classified bargaining units and transferring of \$7 million from the Special Reserve Fund (17) and Deferred Maintenance Fund (14). However, the district is projecting deficit spending in fiscal year 2012-13 by \$6,668,251 and in fiscal year 2013-14 by \$17,725,250. This ongoing and increasing deficit spending appears to be attributed to state aid reductions and on-going operational costs related to restoration of negotiated salary and benefit reductions from 2011-12. This increased level of deficit spending is causing the district shortfalls in available cash reserves necessitating temporary borrowing options and is leaving the district fiscally insolvent by 2013-14 unless actions are taken to implement ongoing, sustainable expenditure reductions. 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’s projected deficit spending is within the established state standard for the current, but **not** the two subsequent fiscal years. The State’s established standard is one-third (1/3) of the district’s available unrestricted reserve percentage.

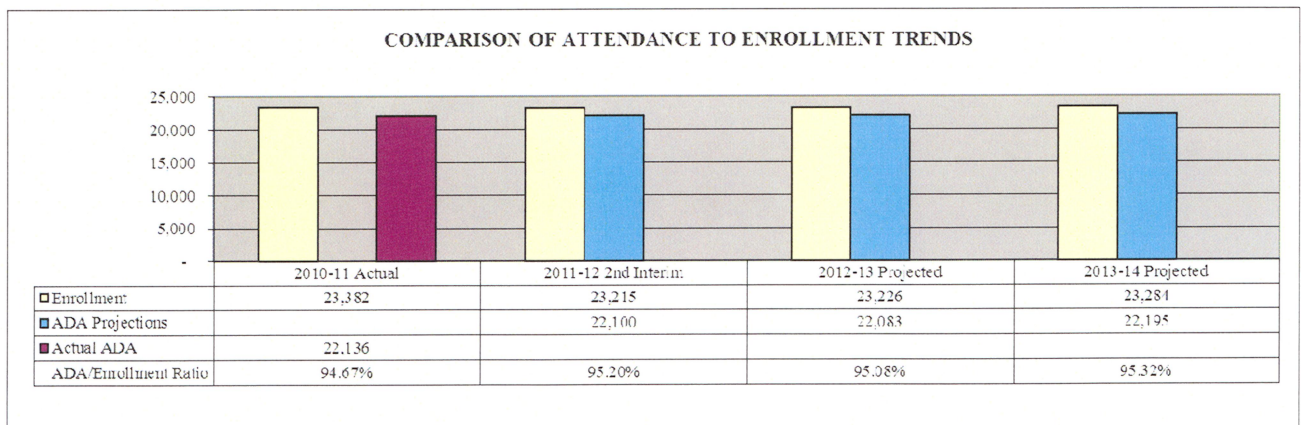
The following chart displays the actual Unrestricted General Fund balance change for the prior fiscal year and the projected change based on the Second Interim Report and board approved multi-year financial projections for the 2011-12 through 2013-14 fiscal years.



- AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2011-12 K-12 P-2 ADA of 22,100 representing a 0.16% decline over prior year P-2 ADA. Based on an enrollment projection of 23,215, the district is anticipating a current year attendance ratio of 95.2%. The district is projecting a 0.08% decline in ADA for 2012-13 and a 0.51% increase in ADA for 2013-14, resulting in an attendance ratio of 95.08% for 2012-13 and 95.32% for 2013-14.

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 **not** within the state standard of 94.43% for each of those years. The district does **not** appear to be projecting ADA at a reasonable level based on state standards. The district has indicated that the increase in 2013-14 is from the planned opening of two new sites to attract students back to the district. Our office recommends that the district continue to closely monitor changes in attendance and enrollment. Overstatement of the ADA to enrollment ratios could generate state aid revenue projections that may not materialize as anticipated. 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 prior year, along with the district’s projected ADA and enrollment for the current 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.



- **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, if ADA does not materialize as projected, revenues will be overstated and require further expenditure reductions.

The district has incorporated a 3.17% Cost of Living Adjustment (COLA) in the 2012-13, but increased the deficit factor to reflect a flat state aid funding level. The district’s state aid funding for fiscal year 2013-14 reflects a flat state aid funding level. However, the district has **not** included the proposed \$370 per ADA state aid trigger reduction, in the two subsequent fiscal years, in the event that the November 2012 tax initiatives fail. The district has indicated as a contingency plan, that \$7.2 million of designated reserves in 2012-13 will be utilized to backfill a portion of the proposed \$370 per ADA loss. Additional expenditure reductions in the 2013-14 fiscal year would be needed, should the revenue loss be an on-going reduction exceeding the \$7.2 million one-time assigned reserve.

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.

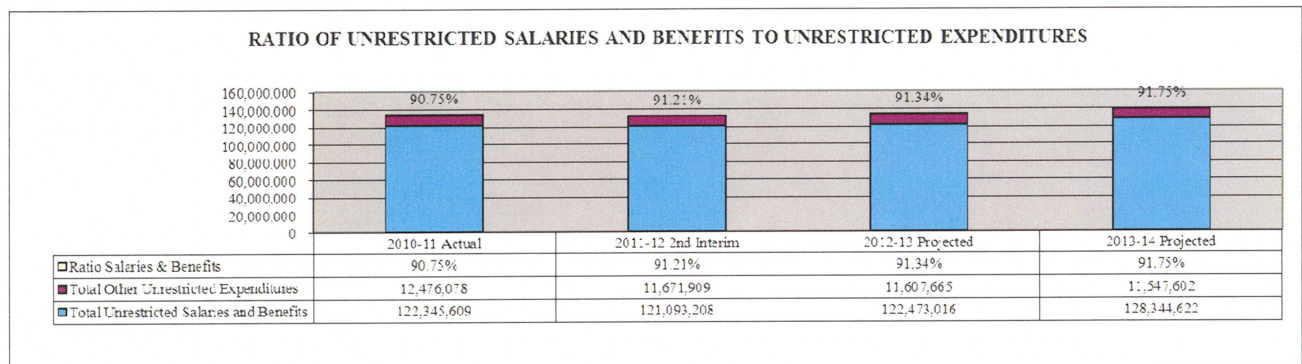
The district has projected for one-time Federal Education Jobs revenues received or deferred to the current fiscal year in the amount of \$372,844. It appears that the district has adjusted the multiyear revenue projections to remove that funding. This funding must be fully expended on or before September 30, 2012.

Our review of the district’s current and projected expenditures indicates \$2.9 million and \$8 million of certificated, classified and management salary and benefit cost reductions were made in the 2011-12 and 2012-13 fiscal years, respectively. The fiscal action plan indicates these reductions have been fully negotiated and approved and represent six(6) and nine(9) certificated furlough days and fourteen(14) management furlough days in 2011-12 and 2012-13 fiscal years, respectively. The classified savings of \$570,000, which represents five(5) furlough days, is not included in fiscal year 2012-13 fiscal year due to expiration of the agreement on June 30, 2012. The district is currently maintaining a 175 day school year.

- **NEGOTIATIONS STATUS AND SALARY AND BENEFIT TRENDS** – The district has indicated that negotiations have been finalized with the certificated and classified bargaining units. The agreement includes a reduction of 3.24% for 2011-12 and 4.86% for 2012-13 to the certificated salary schedules through implementation of six (6) furlough days for the 2011-12 and nine (9) furlough days for the 2012-13 fiscal years. The agreement also includes a delay in step increases in the 2012-13 fiscal year. Details of the agreement were included in our salary disclosure review correspondence (AB1200/AB2756) to the district as part of the qualified certification status. Under the new agreement, the district will reduce the instructional year to 175 days for 2011-12 and 2012-13. The district agreement with the classified bargaining unit provided for five (5) furlough days for the 2011-12 fiscal year which includes reopener language.

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, 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. However, the district's ratio has climbed 90.75% to 91.75% of the total unrestricted general fund expenditures for 2010-11 through 2013-14 fiscal years. This leaves very little available budget for other operational expenditures. 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. This could happen as well with reduced ongoing revenues or uses of one time state or federal revenues. We recommend that the district monitor these ratios and take them into consideration prior to staffing changes or entering into a collective bargaining agreement.



- **LONG TERM DEBT** – The Second Interim Financial Report includes non-voter approved long-term debt of \$23,502,587 which constitutes 12.75% of the district's projected general fund budget. The debt repayment is budgeted in the General and Child Development 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.
- **ONGOING IMPLICATIONS** – On January 5, 2012, Governor Brown released his initial 2012-13 State Budget Proposal that includes major changes for the Education Community. Some of the main points of the proposal are:
 - State revenues are based on the passage of the Governor's Temporary Tax Initiative in November 2012. If the tax initiative is not successful, school districts and county offices of education will be facing an estimated \$370 per ADA mid-year Trigger Cut.
 - Elimination of Home to School Transportation funding was included in the initial proposal. Subsequently, the Governor has proposed to fund Home to School Transportation for the 2012-13 fiscal year and include it as a one-time only adjustment to the weighted student funding formula. By including ongoing support of home to school transportation funding, the state will need to reduce state aid revenues by an estimated additional \$85 per ADA, potentially increasing the state aid reduction for 2012-13 to \$455 per ADA should the tax initiative be unsuccessful. If the tax initiative is passed, the one-time transportation funding for 2012-13 would be paid from funds set aside to reduce state aid deferrals.
 - Implementation of school finance reform using a "Weighted Student Funding Formula", consolidating many major state categorical programs, including EIA, Transportation, K-3 CSR, with the Tier III programs and State Revenue Limit state aid funding. These categorical programs would be combined with revenue limit components and apportioned to districts as a base grant estimated at \$4,920 (no differential is included for high school districts or unified districts compared

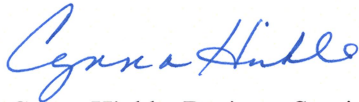
to elementary districts) plus add-ons for concentrations of English Learners (EL) and Free and Reduced Lunch Program students. Funding would be pro-rated in an increasing ratio between existing and new formulas over the next six years.

- An estimated 3.17% COLA that will be unfunded. Instead of increasing the level of funding to schools, the Governor is proposing to buy down a portion of the current state deferrals, but only if his Tax Initiative passes.

Based on these current ever-changing proposals, districts have been advised to “Plan for the Worst and Hope for the Best”. As additional information becomes known with the Governor’s May Budget Revision, our office will continue to provide updates regarding assumptions to be utilized for the 2012-13 Adopted Budget and subsequent fiscal year multi-year projections.

If you have any questions concerning our review of the district’s 2011-12 Second Interim Financial Report, please contact the undersigned.

Sincerely,



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

C:

Dr. Gary S. Thomas, Ed.D., County Superintendent (SBCSS)
Mr. Ted Alejandre, Assistant Superintendent-Business Services (SBCSS)
Mrs. Teri Kelly, Director-Business Advisory Services (SBCSS)

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