



January 14, 2013

Jaime 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 Unified School District 2012-13 First Interim Financial Report.

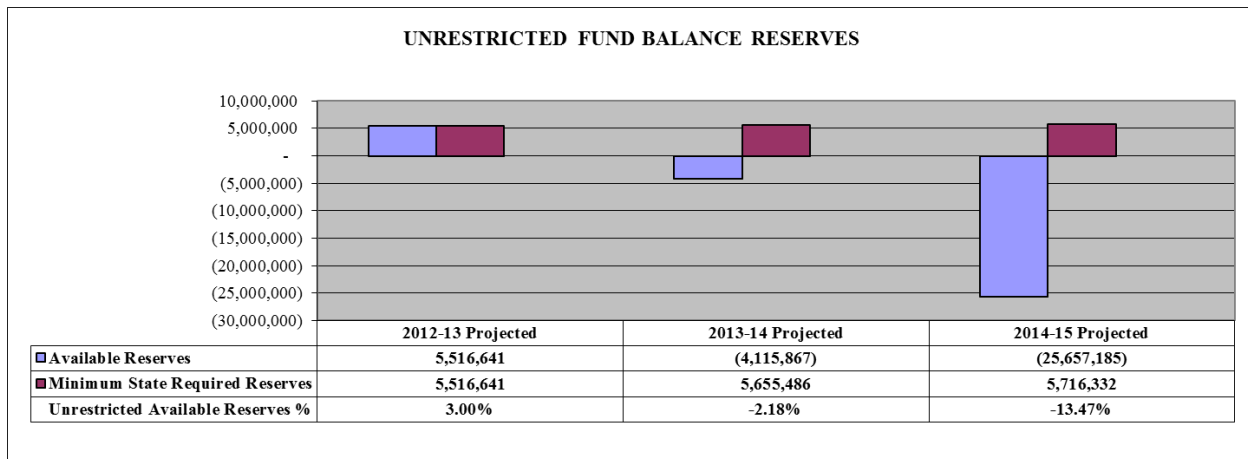
In these tough economic times, the district and governing board need to take actions to maintain fiscal stability in the current and two subsequent fiscal years. The projections submitted to our office indicate that the district is not projecting to meet the state minimum reserve requirement of 3% in the 2013-14 or 2014-15 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 is not able to meet all financial obligations in the current or subsequent two 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, 2012. 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 trends
- Average Daily Attendance (ADA) & Enrollment
- Revenue and Expenditure Projections
- Ending cash 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 3%. The district is projecting unrestricted ending fund balance reserves at **-2.18%** in 2013-14 and at **-13.47%** in 2014-15.

For fiscal years 2013-14 and 2014-15 the district **does not** meet the state required minimum reserve. However, the district submitted board resolution #13-21 recognizing an estimated \$10M and \$11M of unidentified budget reductions for fiscal years 2013-14 and 2014-15, respectively. **While the board has approved the resolution identifying the amount of reductions, the board now needs to identify and approve a plan to implement these expenditure reductions and/or revenue enhancements that will enable the district to meet ongoing financial obligations in the two subsequent fiscal years as part of the Second Interim Financial Report submission. The 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 the dollar amount of savings for each fiscal year. This additional information must be provided as part of the Second Interim Report submission in order to justify a “Positive” certification. Only expenditure reductions that do not require negotiations can be included in the Second Interim Financial Report MYP. If the district board has not taken action to approve the fiscal plan, then a “Qualified” certification would be applicable. The Second Interim report is due to our office no later than March 16, 2013.**



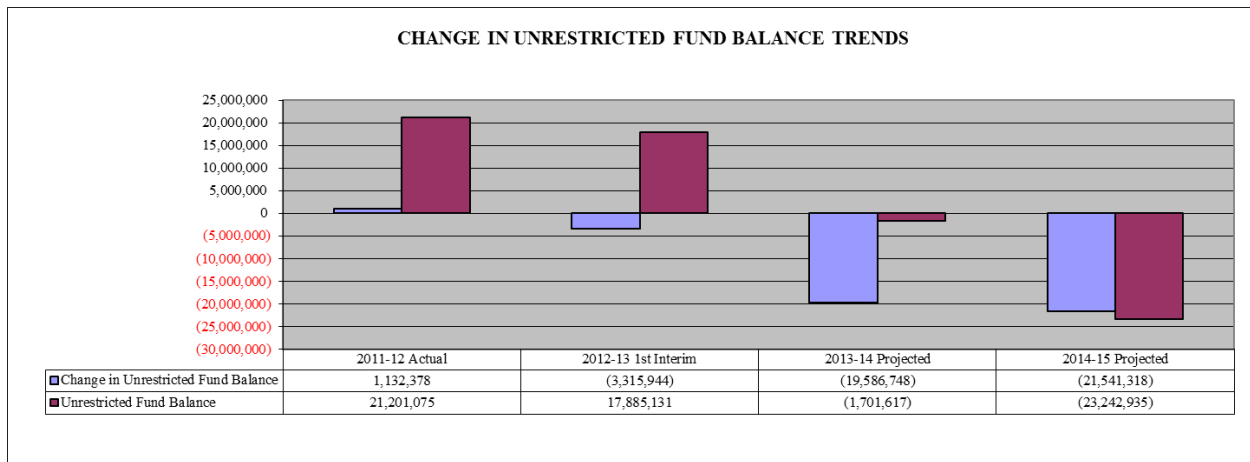
The First Interim Financial Report provides the Governing Board with the opportunity to revise and review its operating budget plan based on the most recent State Budget information and local decisions since the Adopted Budget. This plan should incorporate any updated revenue projections and utilization 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 expenditures to exceed revenues by \$3,315,944 in the current fiscal year, primarily due to addition of staff, startup cost for the opening of Grand Terrace High and Joe Baca Middle schools, implementation of Saturday school, district wide phone system and deferred maintenance projects. The district is continuing this trend of deficit spending in fiscal year 2013-14 by \$19,586,748 and in fiscal year 2014-15 by \$21,541,318. This ongoing and increasing deficit spending appears to be attributed to the reduction in state aid and the expiration of negotiated concessions with bargaining units as of June 30, 2013, and step and column adjustments. 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 projected deficit spending is **not** within the established state standard for the current and two subsequent fiscal years. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

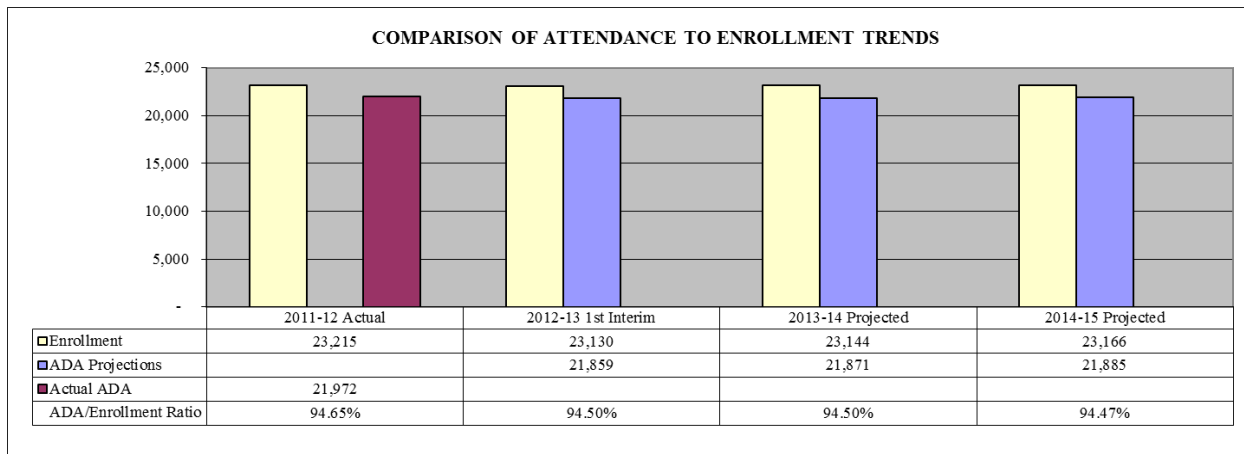
The following chart displays the actual Unrestricted General Fund balance change for the prior fiscal year, the projected change based on the First Interim Report, and board approved multi-year financial projections for the 2013-14 and 2014-15 fiscal years.



- AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2012-13 K-12 P-2 ADA of 21,859 or a -0.55% decline over prior year P-2 ADA. Based on an enrollment projection of 23,130, the district is anticipating a current year attendance ratio of 94.50%. The district is projecting a 0.06% growth in ADA for 2013-14 and a 0.06% growth in ADA for 2014-15, resulting in an attendance ratio of 94.50% for 2013-14 and 94.47% for 2014-15.

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 94.87% for each of those years. The district is projecting a growth of 36 students in subsequent years compared to historical trends of decline primarily due to the implementation of Saturday school. 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 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.



- 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.

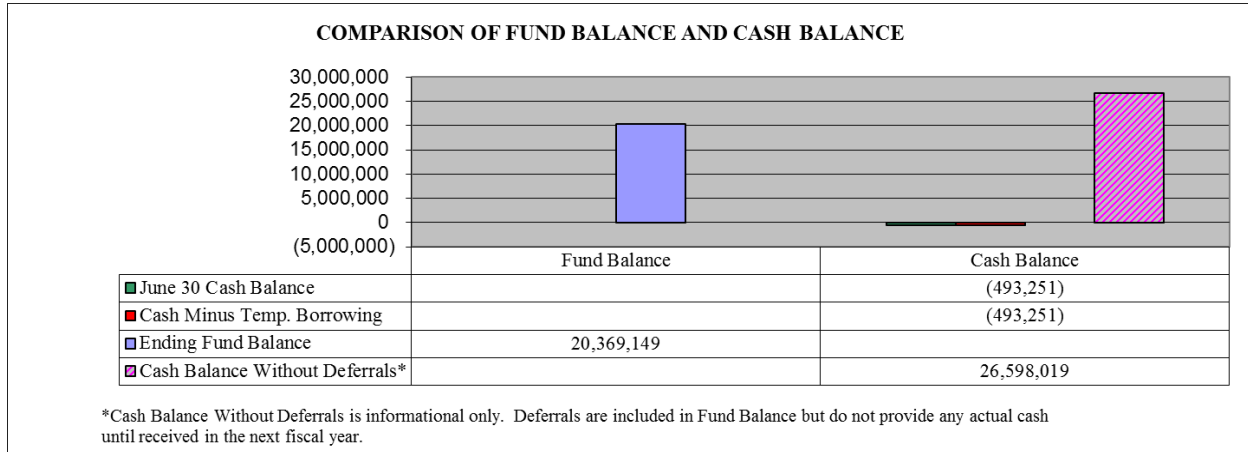
The district is projecting a decline in current year ADA and is utilizing the state’s prior year guarantee of ADA in the state aid revenue limit projections. The state allows districts to utilize the current or prior year P-2 district ADA, whichever is higher, to determine annual state aid revenue limit 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.

Our review of district current and projected expenditures indicates that the district has made \$8,333,507 of reductions in salary costs in the 2012-13 fiscal year. As part of the district’s Multiyear Projection (MYP), it submitted board resolution #13-20 for fiscal year 2013-14 and 2014-15 recognizing \$10M and \$11M, respectively in on-going budget reductions to be implemented beginning in 2013-14.

- ENDING CASH POSITION AND MONTHLY CASH FLOWS** – Due to the current State Budget including ongoing deferrals of state revenues, changes in apportionment distribution schedules, inclusion of Education Protection Account (EPA) funds, 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 indicates that the district will not have sufficient cash in the months of May and June 2013 unless further expenditure reductions; revenue enhancements or temporary borrowing is implemented. The district’s cash flow reflects the June 30 cash balance as **-2.42%** of the projected 2012-13 Ending Fund Balance.

The district’s revenue limit is computed to be 6.23% Property Taxes and 93.77% State Aid, which means your district will realize a greater loss of cash due to state deferrals than a higher property tax district. To maintain a positive cash position, the district used Inter-fund borrowing of \$19,000,000 from the Capital Facilities and Self-Insurance Funds which is scheduled to be repaid in April 2013. In addition, the district used a Tax Revenue Anticipation Note of \$9,930,000, which requires repayment by March 2013. The district anticipates utilizing Inter-fund borrowing and a mid-year Tax Revenue Anticipation Note to maintain a positive cash position at year-end. To ensure adequate cash will be available for this borrowing, please submit a detailed cash flow for these funds with the Second Period Interim Report. The district could borrow up to the estimated \$33M in state deferrals in May 2013 to cover anticipated

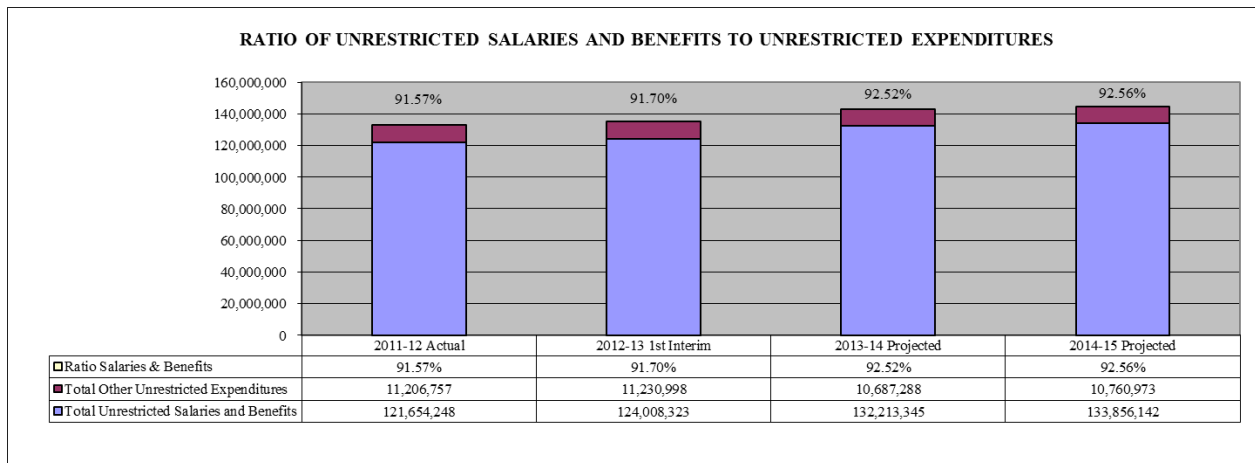
cash deficit. **The ongoing level of deficit spending, Inter-fund borrowing and Tax Revenue Anticipation Notes needed to meet anticipated monthly obligations is an indication of a structural budget problem. The district will be facing cash insolvency if expenditure trends are not reduced.**



- STAFFING PROJECTIONS/SALARY SETTLEMENTS** – The district has indicated that negotiations have been finalized with the certificated and/or classified bargaining units. The documents also indicate that there are no potential salary schedule increases or decreases included in the adopted budget or subsequent fiscal years. However, as noted earlier, the district agreements with the bargaining units expire June 2013 and the previously \$8.3M budget reductions as a result of furlough days are restored in the salary and benefit multiyear projections. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 7%, since the district currently does not have a cap on the employer cost of health benefits. This escalating cost increase for full health benefit coverage is one of the factors contributing to the ongoing deficit spending projected by the district.

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, 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. **However, salaries and benefits in the current year consume 91.7% of the total General Fund unrestricted expenditure budget.** 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 with reduced revenues as well. We recommend that the district monitor these ratios and take them into consideration prior to staffing changes or entering into a collective bargaining agreement.



- **MULTI-YEAR PROJECTIONS** – The district is projecting to meet minimum state reserves with 3% in 2012-13, but not in 2013-14 with **-2.18%** and **-13.47%** in 2014-15. As indicated earlier, the district has submitted a resolution recognizing the need for \$10M and \$11M in budget reductions needed to be implemented beginning in fiscal year 2013-14. The district has not identified a fiscal recovery plan that has been fully approved by the governing board. The district has incorporated a 0.00% Cost of Living Adjustment (COLA) in the 2013-14 and 2014-15 fiscal years as a contingency plan in the event the COLA is not funded as recommended by our office. **The district must submit a board approved fiscal recovery plan with the Second Interim Report. Our office recommends that the district continue to be proactive by developing contingency plans in response to the current state economy’s potential for further changes in the Governor’s 2013-14 January Budget proposals.**
- **LONG TERM DEBT** – The First Interim includes non-voter approved long-term debt of \$19,123,692 which constitutes 10.40% of the district’s projected general fund budget. The debt repayment is budgeted in the General, Child Development, and Self-Insurance 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 2012-13 First Interim Financial Report, please contact the undersigned.

Sincerely,

Lisa Regalado  
 Business Services Advisor  
 Business Advisory Services  
 (909) 386-9678

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cc: Cynna Hinkle, Director Business Advisory Services, SBCSS  
 Ted Alejandro, Assistant Superintendent Business Services, SBCSS

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