April 15, 2010

Mr. Mel Albiso, Board President
Colton Joint Unified School District
1212 Valencia Drive
Colton, CA 92324-1798

Dear Mr. Albiso:

Thank you for the submission of the district's **2009-10 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.

The Office of the San Bernardino County Superintendent of Schools has reviewed the Second Interim Financial Report submitted by the **Colton Joint Unified School District** for the period ending **January 31, 2010.** Our review included an assessment and analysis of the following major components of the district's report:

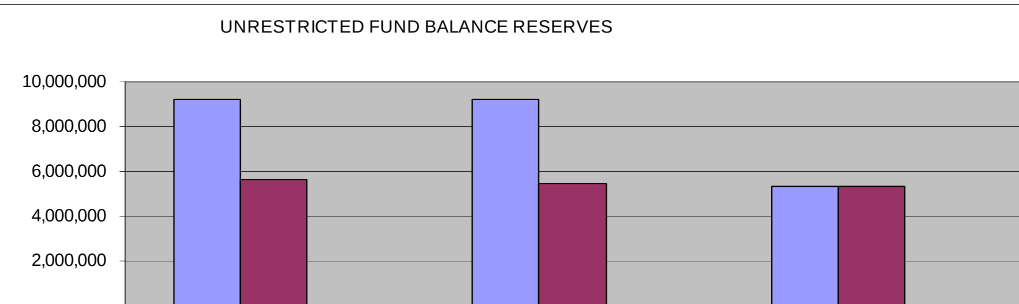
- Unrestricted Ending Fund Balance and State Minimum Reserve
- Unrestricted Deficit Spending Trends
- Average Daily Attendance (ADA) & Enrollment Projections
- Revenue and Expenditure Projections
- Ending Cash Position and Monthly Cash Flow Projections
- Salary Settlements/Staffing Projections
- Multi-year Financial Projections/Reserves
- Long Term Debt

Based on our analysis, the data provided supports the Governing Board's ***Positive Certification*** of the district's financial condition and ability to meet its financial obligations. The district's unrestricted reserve balances meet the minimum state criteria and standards for the current and two subsequent years.

- **UNRESTRICTED ENDING FUND BALANCE AND STATE MINIMUM RESERVE –** As certified by the district's Governing Board, the Second Interim Financial Report projects an unrestricted ending fund balance reserve in the General Fund of 4.89%. The district is projecting unrestricted ending fund balance reserves at 5.06% in 2010-11 and at 3.01% in 2011-12.

For fiscal years 2010-11 and 2011-12, the district has submitted a Board approved fiscal action plan recognizing $10,391,438 in on-going expenditure reductions to be implemented as of July 1, 2010, which have been included in the district's multiyear projections. As part of this plan, the district's Governing Board has approved Reduction In Force (RIF) notices totaling $9,570,516 and a reduction of five work days for management totaling $360,941. However, in order to realize this level of ongoing staff reductions, the district will need to complete ongoing negotiations implementing reduction in work days and increases in class sizes. In addition, the district has also included an additional $11,061,134 in budget reductions for fiscal year 2011-12, which still need to be identified and negotiated. Once the final fiscal plan is negotiated and approved, please provide our office with a copy of the detailed plan of action.

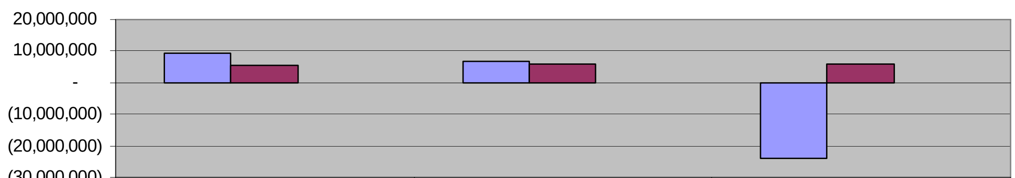
Since the submission of the Second Interim Financial Report, our office has had discussions with district staff regarding the level of negotiable reductions that have been included in the multi-year projections. District staff has identified $7.5 million in one-time sources of revenue and designations that the district could utilize should negotiations not be finalized by July 1, 2010. Although the district has identified $7.5 million that would allow the district to meet the required minimum state reserves for fiscal year 2010-11, the district would be insolvent for fiscal year 2011-12, unless these negotiable ongoing reductions are implemented. We would like to stress that these are all one-time resources for fiscal year 2010-11 and delaying on-going expenditure reductions will force the district to make even deeper reductions of over $30 million in fiscal year 2011-12. This additional fiscal action plan for fiscal year 2010-11 would need to be implemented with the district's 2010-11 Adopted Budget, if negotiations have not been finalized.



	2009-10 PROJECTED	2010-11 PROJECTED	2011-12 PROJECTED
Available Reserves	9,218,579	9,223,857	5,354,205
Minimum State Required Reserves	5,652,745	5,471,516	5,340,924
Unrestricted Available Reserves %	4.9%	5.1%	3.0%

UNRESTRICTED FUND BALANCE RESERVES

**WITHOUT NEGOTIATED ITEMS AND WITH $7.5 MILLION OF ONE TIME REVENUE SOURCES
SUBMITTED TO THE BOARD OF EDUCATION APRIL 15, 2010**



	2009-10 PROJECTED	2010-11 PROJECTED	2011-12 PROJECTED
Available Reserves	9,218,579	6,963,221	(24,163,209)
Minimum State Required Reserves	5,652,745	5,688,581	5,894,624
Unrestricted Available Reserves %	4.89%	3.67%	-12.30%

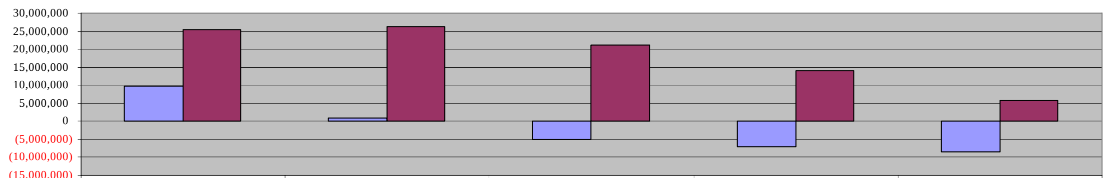
The Second Interim Financial Report provides the Governing Board with the opportunity to revise and review the district's operating budget plan based on the most recent State Budget proposals and local decisions since the First Interim Financial Report. This plan should incorporate any updated revenue 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:

- **UNRESTRICTED DEFICIT SPENDING –** The district is projecting unrestricted expenditures to exceed unrestricted revenues by $5,118,222 in the current fiscal year, primarily due to the loss of state aid and on-going operational expenditures. The district is continuing this trend of deficit spending in fiscal year 2010-11 by $6,991,992 and in fiscal year 2011-12 by $8,497,579. This increased deficit spending appears to be attributed to the loss of state aid and on-going operational costs. Anticipated deficit spending should be for one time, non-recurring expenditures to avoid depletion of the district's on-going unrestricted reserves.

  The district's deficit spending is not within the established state standards for the current fiscal year and the two subsequent fiscal years. If the Governing Board does not take actions to reduce or eliminate ongoing deficit spending in the future years, the district faces fiscal insolvency by 2011-12. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

  The following chart displays the actual Unrestricted General Fund balance change for the two prior fiscal years and the projected change based on the Second Interim Report and Governing Board's approved multi-year financial projections for the 2009-10 through 2011-12 fiscal years.

CHANGE IN UNRESTRICTED FUND BALANCE TRENDS



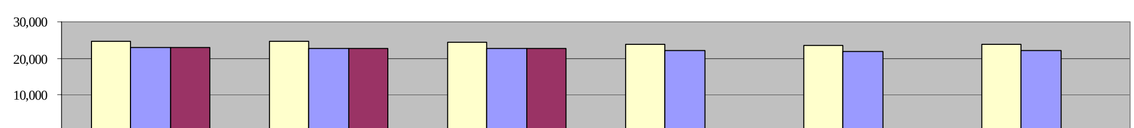
	2007-08 Actual	2008-09 Actual	2009-10 2nd Interim	2010-11 Projected	2011-12 Projected
Change in Unrestricted Fund Balance	9,668,328	914,088	(5,118,222)	(6,991,992)	(8,497,579)
Unrestricted Fund Balance	25,466,310	26,380,397	21,170,631	14,178,639	5,681,060

- **AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2009-10 K-12 P-2 ADA of 22,155.32 or a 2.41% decline over prior year P-2 ADA. Based on an enrollment projection of 23,960, the district is anticipating an attendance ratio of 92.5%. Additionally, the district is projecting a 0.85% decline in ADA and 1.12% decline in enrollment for 2010-11, and a 0.49% increase in ADA and a 0.48% increase in enrollment for 2011-12. The district's three-year average of P-2 ADA change has been a decrease of 0.52% and enrollment decrease of 0.66%.

  Based on the enrollment and ADA projections for the current and two subsequent fiscal years, the district is within the state standard attendance ratio of 93.4% for each of those years. Although the district appears to be projecting ADA at a reasonable level based on historical trends, our office is concerned with the projected loss of ADA in the 2009-10. The district has indicated that they anticipate an additional loss of 170 ADA with the current year P2 attendance report. This loss equates to a reduction of $882,419 in state aid that has **not** been included in the multi-year projections. 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 Governing Board will need to adjust the budget accordingly.

  The following chart displays the district's actual P-2 ADA and enrollment in the three prior years, along with the district's projected ADA and enrollment for the Second Interim Financial Report and two subsequent fiscal years. Since a significant portion of a school district's revenue is derived from ADA, it is imperative to closely monitor the correlation between enrollment and ADA.

COMPARISON OF ATTENDANCE TO ENROLLMENT TRENDS



	2006-07 Actual	2007-08 Actual	2008-09 Actual	2009-10 2nd Interim	2010-11 Projected	2011-12 Projected
Enrollment	24,565	24,543	24,362	23,960	23,606	23,719
ADA Projections	22,894	22,663	22,702	22,155	21,966	22,074
Actual ADA	22,895	22,748	22,702			
ADA/Enrollment Ratio	93.20%	92.34%	93.19%	92.47%	93.05%	93.07%

- **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 revenue limit does not appear to be reasonable for the 2010-11 fiscal year due the district's loss of additional ADA in the current year. Although 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 ADA that is currently being utilized in the projections is higher than the current ADA being generated by the students. 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 Federal Stimulus (ARRA) revenues received or deferred to the current fiscal year in the amount of $7,218,148. It appears that the district has adjusted the multiyear revenue projections to remove that funding that is being utilized in the current year. The district anticipates to defer a portion of ARRA funding to be spent in the 2010-11 fiscal year. Our office recommends the district remove one time revenues and one time only expenditures from the multiyear projections. If any of these expenditures are ongoing, they need to be transferred back to an unrestricted funding source for future years.

  For fiscal year 2010-11 the district is including $5.47 million to be transferred from the Special Reserve Fund for Capital Outlay Projects (Fund 40) to the General Fund. In addition, as noted above, in order for the district to meet the required reserves for fiscal year 2010-11, the district has identified $1.0 million from the Self-Insurance Fund (Fund 67) to be transferred to the General Fund. These sources are one-time revenues of $6.47 million that is assisting the district with reducing deficit spending in 2010-11, but is contributing to the higher level of reductions that will be required by 2011-12. Our office is very concerned about the level of one-time sources that the district is utilizing for the 2010-11 fiscal year. It is in the best interest of the district to reduce on-going expenditures rather than relying on one-time revenue sources. The increased deficit spending in fiscal year 2011-12 is beyond a reasonable and manageable level, and our office is very concerned with the district's ability to resolve this level of reductions within a one-year time period.

  Our review of district current and projected expenditures indicates that the district has made $9,931,457 of reductions in salary costs in the 2010-11 fiscal year and $11,061,134 in fiscal year 2011-12. The fiscal action plan indicates these reductions have not been fully negotiated and represent a reduction of 150 FTE. The reduction of five work days (furlough days) has been approved for management only. If this assumption does not materialize, the district's deficit spending trend will increase and the district will not meet state minimum reserves starting in 2010-11. Please keep our office apprised monthly of the status of negotiations on these items as this may affect whether or not the district's 2010-11 budget can be approved by our office.

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- **ENDING CASH POSITION AND MONTHLY CASH FLOW PROJECTIONS –** The monitoring and projection of monthly cash balances have become increasingly critical to ensure fiscal solvency 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 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 anticipates a positive cash balance at the end of each month and at the end of the fiscal year.

- **SALARY SETTLEMENTS/STAFFING PROJECTIONS –** The district has indicated that negotiations have not been finalized with the certificated and classified bargaining units. The documents also indicate that there are no potential increases included in the current projected budget or subsequent fiscal years, with the exception of annual step and column adjustments. As noted earlier, the district has projected for staffing reductions of 150 FTE, which are included in the multiyear financial projections. However, these reductions may not be able to be fully implemented without ongoing negotiations on class sizes and work year reductions. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 10%, since the district currently does not have a cap on the employer cost of health benefits. This escalating cost increase for full health benefit coverage is one of the factors contributing to the ongoing deficit spending projected by the district.

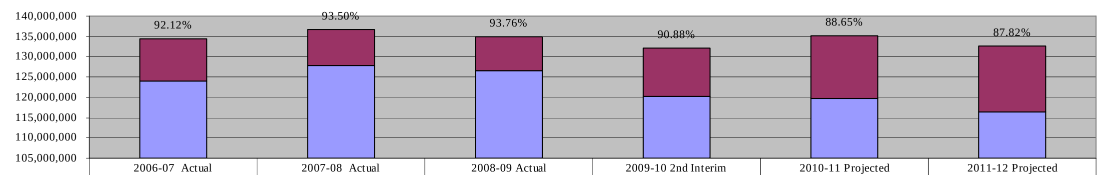
  Pursuant to AB1200/AB2756, please provide an analysis of the cost of any proposed agreement(s), including the impact on the current operating budget and multi-year financial projections, **at least ten days prior to adoption by the Governing Board**. Budget transfer documents implementing any adjustment(s) must also be provided to our office no later than 45 days after approval of the agreement by the Governing Board. If the costs associated with a negotiated salary or benefit increase reduce the available unrestricted ending balance below the required state minimum reserve level in the current and/or two subsequent fiscal years, the district's 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 three years, current year's Second Interim Financial Report 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 of 90.1% to 96.1% in the current year only. 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 prior to staffing changes or entering into a collective bargaining agreement.

RATIO OF UNRESTRICTED SALARIES AND BENEFITS TO UNRESTRICTED EXPENDITURES



	2006-07 Actual	2007-08 Actual	2008-09 Actual	2009-10 2nd Interim	2010-11 Projected	2011-12 Projected
Ratio Salaries & Benefits	92.12%	93.50%	93.76%	90.88%	88.65%	87.82%
Total Other Unrestricted Expenditures	10,594,149	8,879,064	8,421,611	12,057,500	15,337,145	16,153,537
Total Unrestricted Salaries and Benefits	123,899,826	127,728,316	126,579,822	120,196,335	119,732,412	116,498,208

- **MULTI-YEAR FINANCIAL PROJECTIONS –** The district is projecting to meet minimum state reserves in all fiscal years. The district is projecting 4.89% in 2009-10 5.06% in 2010-11 and 3.01% in 2011-12. As noted earlier, the district is including negotiable items to be implemented for the 2010-11 and 2011-12 fiscal years in order to meet minimum state reserve standards. Some of these items are still pending final negotiations and approval. Additionally, the district has provided our office with additional one time only resources that could cover a portion of these ongoing reductions in order to meet 2010-11 reserves. However, should these assumptions not materialize as reported, the district will not meet minimum state reserve standards in the 2011-12 fiscal year.

- **LONG TERM DEBT –** The Second Interim Financial Report includes non-voter approved long-term debt of $17,513,047 which constitutes 9.07% 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. **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**.

Our office recommends that the district continue to be proactive by developing contingency plans in response to the current state economy and potential for ongoing state budget reductions in the Governor's May Revise Budget proposals for the balance of fiscal years 2009-10 and 2010-11.

If you have any questions concerning our review of the district's 2009-10 Second Interim Financial Report, please contact the undersigned.

Sincerely,

Signed by:
Cynna Hinkle, Advisor
Business Advisory Services
(909) 777- 0745

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