



March 26, 2013

Mohammad Z. Islam
Associate Superintendent, Business Services
Rialto Unified School District
182 East Walnut Avenue
Rialto, CA 92376-3598

Dear Mr. Islam:

Thank you for the submission of the district's **2012-13 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.

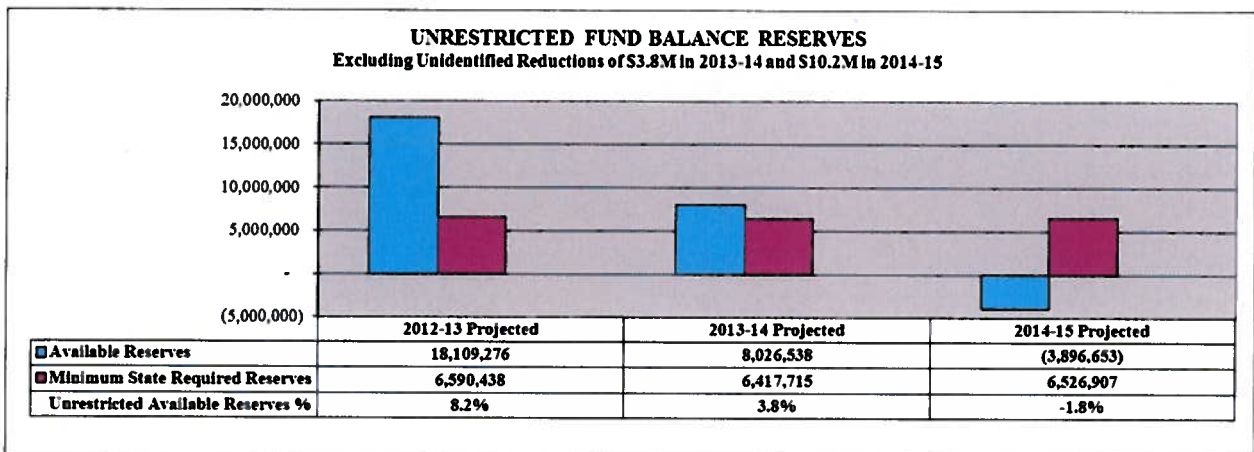
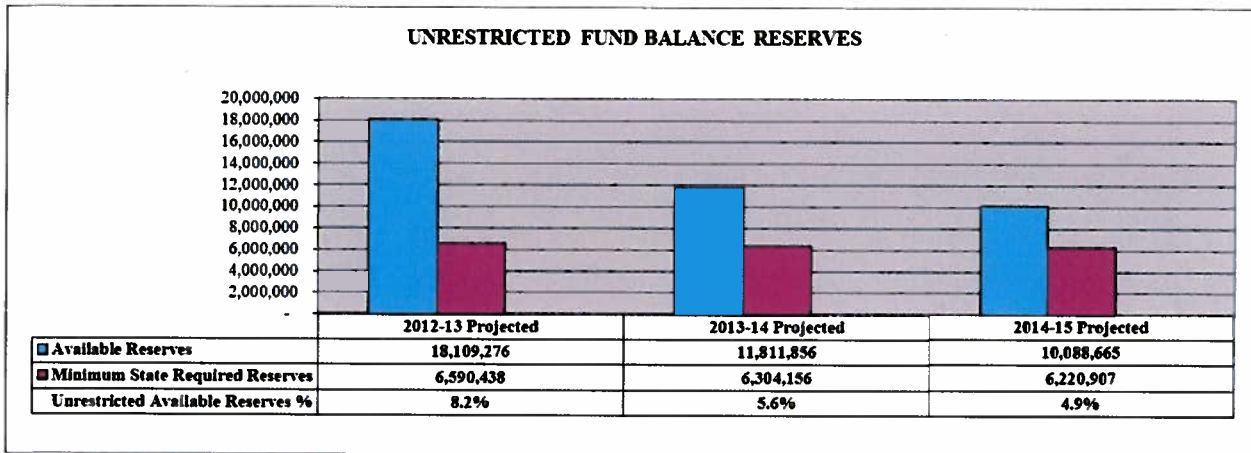
The Office of the San Bernardino County Superintendent of Schools has reviewed the Second Interim Financial Report submitted by the Rialto Unified School District for the period ending **January 31, 2013**. Based on our analysis, the data provided supports the board's **Positive Certification** of the district's financial condition and ability to meet its financial obligations in the current and two subsequent fiscal years.

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
- Ongoing Implications

- 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 balance reserve in the General Fund of 8.2%. The district is projecting unrestricted ending fund balance reserves at 5.6% in 2013-14 and at 4.9% in 2014-15 with the inclusion of \$3.8M of non-negotiable reductions in 2013-14 and an additional \$6.4M in negotiable and non-negotiable reductions in 2014-15.

The district Governing Board has identified and approved a plan to implement budget reductions as part of the Second Interim Financial Report submission. The plan identifies the expenditure reductions as ongoing, beginning in fiscal year 2013-14, and identifies projected savings for both negotiable and non-negotiable items.



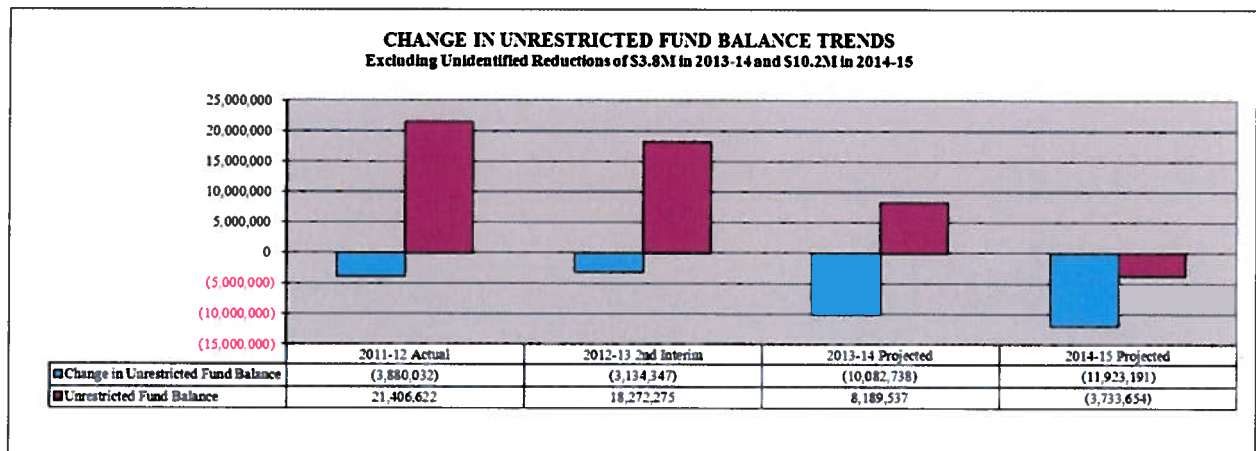
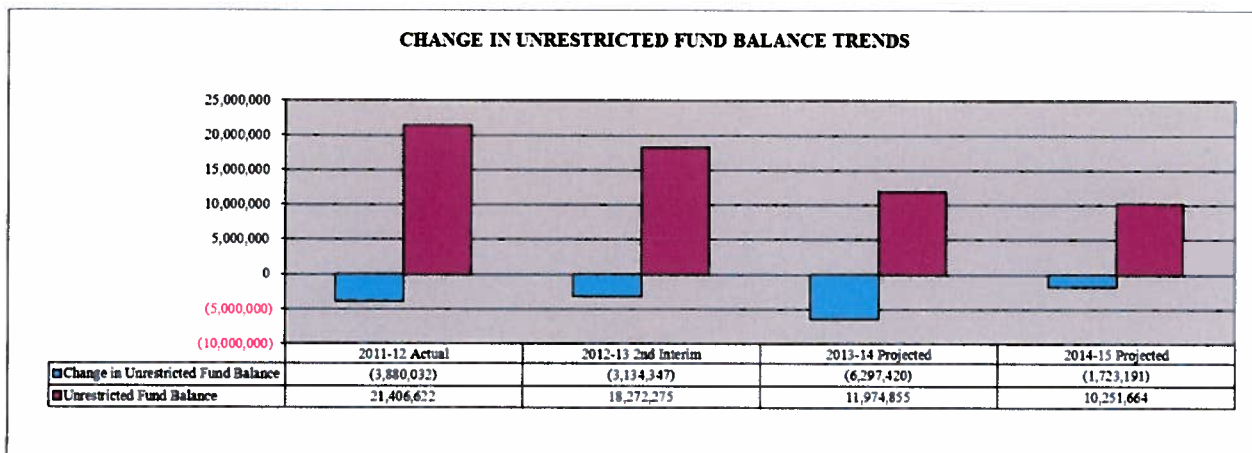
The Second Interim Financial Report provides the Governing Board with the opportunity to revise and review its operating budget plan based on the most recent State Budget information and local decisions made since the Adopted Budget. This plan should incorporate any updated revenue projections and utilization of expenditures to meet the goals and financial obligations of the school district in the 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 \$3,134,347 in the current fiscal year, primarily due to a high salaries and benefits ratio, uncapped health and welfare benefits, expenditure of budgeted carryover, and other ongoing

operational costs. The district is continuing this trend of deficit spending in fiscal year 2013-14 by \$6,297,420 and in fiscal year 2014-15 by \$1,723,191. Deficit spending would increase to \$10.1M in 2013-14 and \$11.9M in 2014-15 and leave the district fiscally insolvent if the \$10.2M of budget reductions is not achieved. This ongoing and increasing deficit spending appears to be attributed to the expiration of bargaining unit concessions, high salaries and benefit ratio, uncapped health and welfare benefits, and other ongoing 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 projected deficit spending is within the established state standard for the current fiscal year but not the two subsequent fiscal years when the unallocated reductions are excluded. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

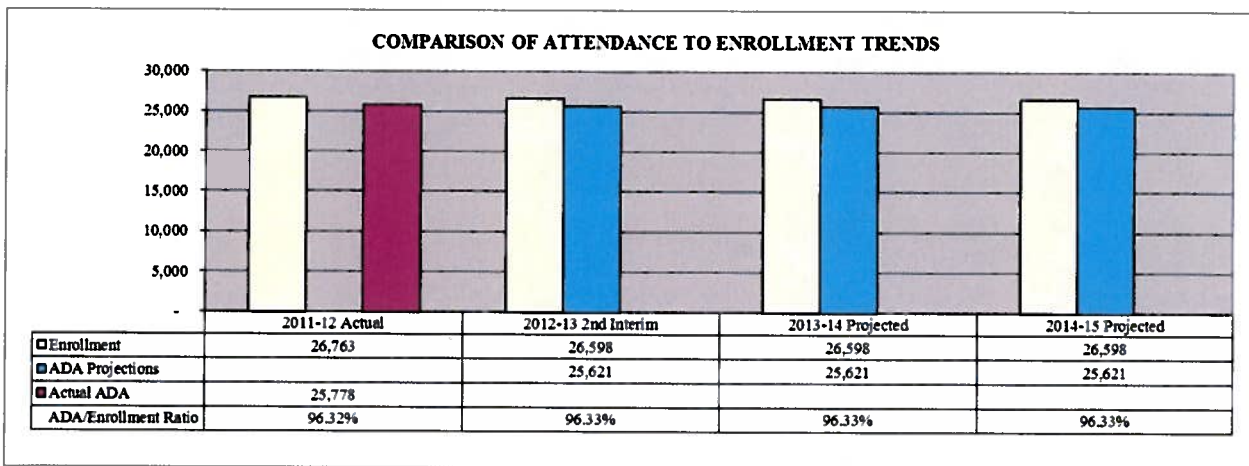
The following chart displays the actual Unrestricted General Fund balance change for the prior fiscal year, the projected change based on the Second Interim Report, and board approved multi-year financial projections for the 2013-14 and 2014-15 fiscal years.



- AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2012-13 K-12 P-2 ADA of 25,620.92 or a 0.61% decline over prior year P-2 ADA. Based on an enrollment projection of 26,598, the district is anticipating a current year attendance ratio of 96.33%. The district is projecting a no change in ADA or attendance ratio for 2013-14 and 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 not within the state standard of 95.8% for each of those years. Although the district is projecting a higher ADA to enrollment ratio than the state standard, the projection is based on current ADA recovery rates achieved through its Saturday School program in fiscal year 2011-12. 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.

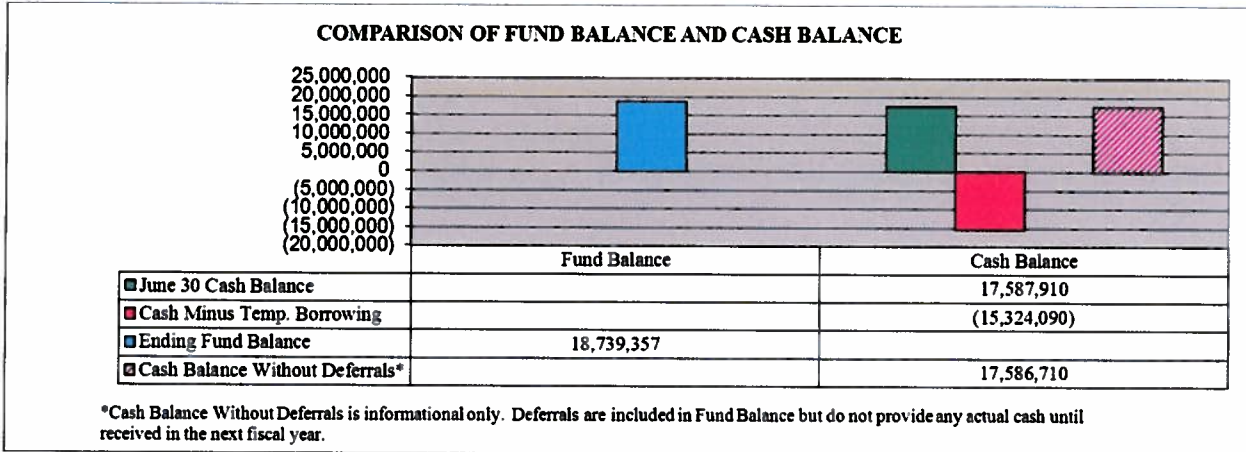


- **REVENUE AND EXPENDITURE PROJECTIONS** – Our review included an analysis of the district’s projection of revenues and expenditures in the current and two subsequent fiscal years. The district’s projection of current and subsequent state aid appears to be reasonable.

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.

- **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 have a positive cash balance at the end of each month and at the end of the fiscal year. The district’s cash flow reflects the June 30 cash balance as **-81.77%** of the projected 2012-13 Ending Fund Balance if temporary borrowing is excluded. The district’s revenue limit is computed to be 7.9% Property Taxes and 92.1% 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 Tax Revenue Anticipation Notes (TRANS) of \$17.68M that was repaid in January, and a Midyear TRANS of \$39.655M, which requires repayment by August 2013. This amount of borrowing is almost 90% of the districts total projected revenue accruals and well over the projected Revenue Limit deferral of \$32.9M. The total amount of TRANS is related to Revenue Limit deferrals and other Federal and State program revenues received on an accrual basis. **This indicates a structural budget deficit that could result in the district being cash insolvent unless budget reductions are implemented and deficit spending eliminated.** A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available.



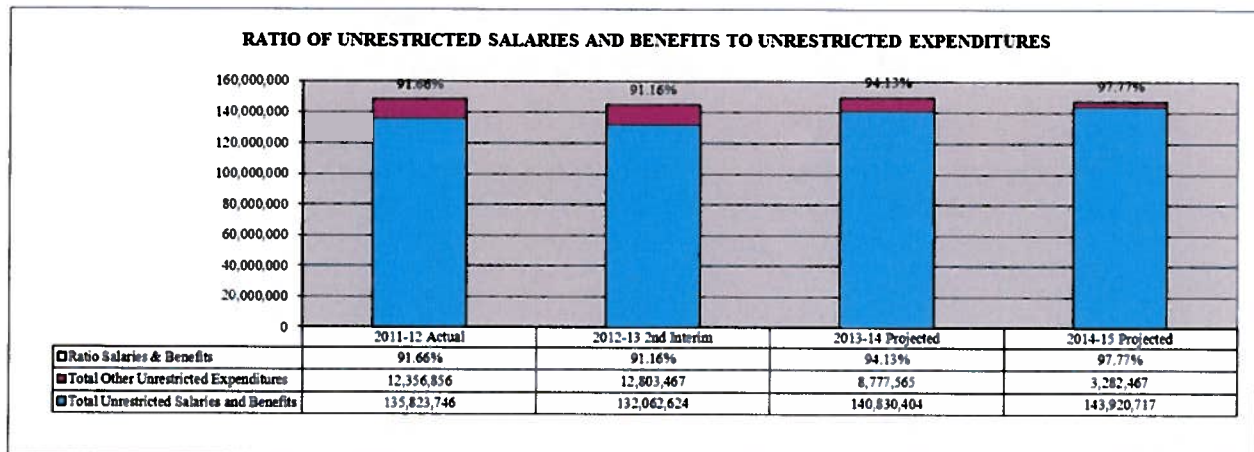
- STAFFING PROJECTIONS/SALARY SETTLEMENTS** – The district has indicated that certificated salary negotiations have been concluded but classified salary negotiations are still ongoing for the 2011-12 and 2012-13 fiscal years. Annual step and column adjustments are included for both units in each year. The certificated agreement includes five furlough days and 100% employer-paid benefits. The district is maintaining a 177-day school year for fiscal year 2012-13. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 9.78%, 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 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, **at least ten days prior to adoption by the board.** Budget transfer documents implementing any adjustment(s) must also be input into 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. 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 prior 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 for the current year. **The salaries and benefits are consuming 91.2% of the expenditure budget in the current year, which is higher than our recommended percentage of 85%.** Ratios for the two subsequent years are skewed by the inclusion of unallocated budget reductions; however, based on the district’s proposed budget reduction plan, we estimate the ratios to be approximately 91.6% for 2013-14 and 91.0% for 2014-15. 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 in all fiscal years with 8.2% in 2012-13, 5.6% in 2013-14 and 4.9% in 2014-15. However, the district has incorporated \$10.2M in budget reductions that were approved by resolution of the governing board on February 27, 2013 in the projections for the two subsequent fiscal years. **Without these reductions, the district would be fiscally insolvent in the 2014-15 fiscal year.** The district supplied our office with an implementation plan for these reductions. The district has incorporated a 1.65% Cost of Living Adjustment (COLA) in the 2013-14 and 2.20% for 2014-15 fiscal years as recommended by School Services of California’s (SSC) dartboard. **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 to the Governor’s 2013-14 January Budget proposals.**
- LONG TERM DEBT** – The district’s 2011-12 Audit Report includes non-voter approved long-term debt of \$25,574,315 which constitutes 11.66% of the district’s projected General Fund budget. The debt repayment is budgeted in the General, Child Development, and Capital Facilities Funds. The district should monitor 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.

- **ONGOING IMPLICATIONS** – On January 10, 2013, Governor Brown released his initial 2013-14 State Budget Proposal that includes major changes for the Education Community. Some of the main points of the proposal are:
 - A new funding model called the Local Control Funding Formula (LCFF). Like last year's Weighted Student Formula, the LCFF combines Economic Impact Aid (EIA), K-3 Class Size Reduction (CSR), Tier III programs, and Revenue Limit funding with add-ons for Transportation and Targeted Instruction Improvement Grant (TIIG) funding. This funding would include approximately \$1.6B to reduce the difference between current funding levels and funding calculated using the LCFF formula.
 - An estimated 1.65% COLA funding increase that will vary in its effect on districts if the LCFF is enacted.
 - An additional \$1.8B to reduce inter-year deferrals.

The Governor is very motivated to implement the LCFF, but it has received a mixed reception thus far. 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 2013-14 Adopted Budget and subsequent fiscal year multi-year projections.

If you have any questions concerning our review of the district's 2012-13 Second Interim Financial Report, please contact the undersigned.

Sincerely,



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Business Services Advisor
Business Advisory Services
(909) 386-9675

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cc: Cynna Hinkle, Director, Business Advisory Services

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