

July 26, 2013

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

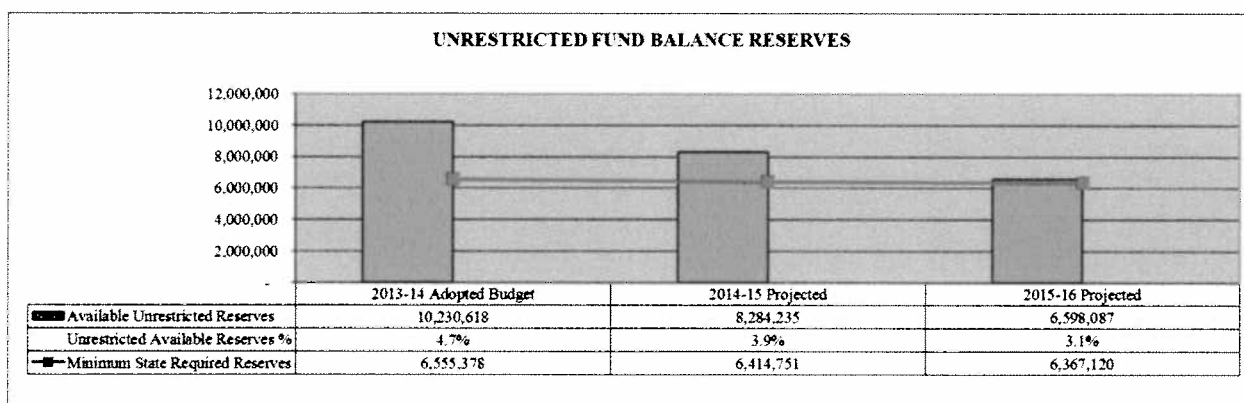
Dear Mr. Islam:

Thank you for the submission of the district's 2013-14 Adopted Budget. We recognize the district's efforts in the development of a budget and financial plan that provides for the ongoing financial stability of the district in these tough economic times. On June 27, 2013, the Governor signed the State Budget Act, AB 110, and on July 1, 2013 the accompanying trailer bills AB97 (K-12 Local Control Funding Formula (LCFF) and AB86 (K-14 education omnibus). The provisions of these bills were used in our review.

Subsequent to the district's approval of the 2013-14 Adopted Budget, the funding structure for state aid allocations has changed dramatically with the passage of the AB97. Over the next few months, the education community must assess the budget impact of these changes on an individual basis. We will continue to provide guidance throughout this process. While we have considered these changes during our budget review process, we anticipate reviewing the full impact of this change with the district's First Interim Financial Report due to our office on December 16, 2013.

The 2013-14 Adopted Budget of the **Rialto Unified School District** has been reviewed and **approved** pursuant to the provisions of Education Code Section 42127 (a) through (d).

As adopted by the district's Governing Board, the budget reflects an unrestricted ending balance reserve in the General Fund of 4.7%. The district is projecting unrestricted ending fund balance reserves at 3.9% in 2014-15 and at 3.1% in 2015-16.



The approval of the Adopted Budget is based on an assessment and analysis of the following additional major components of the district's budget:

- Unrestricted Deficit Spending Trends
- Average Daily Attendance (ADA) & Enrollment Projections
- Current and Multiyear Projections
- Negotiations Status/Salaries and Benefits Trends
- Long Term Debt
- Cash Flow
- Future Risks
- State Enacted Budget – 45 Day Revision

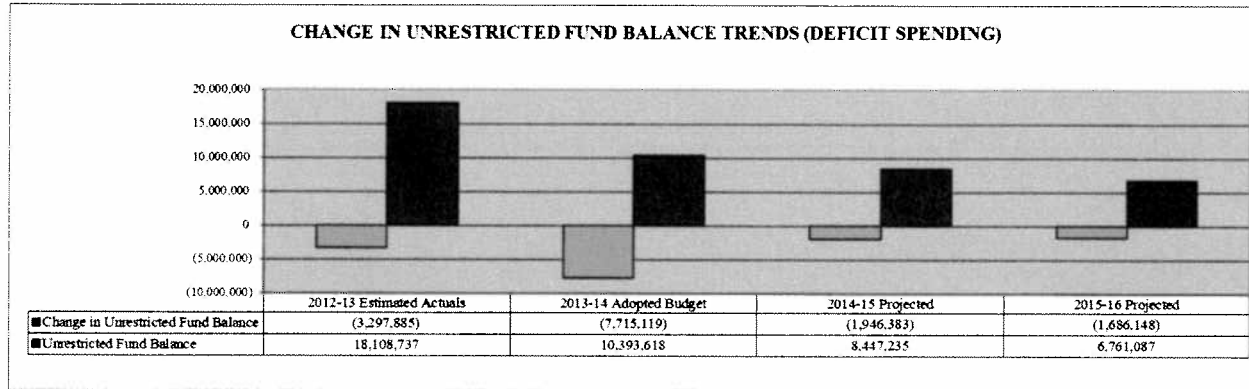
The budget is a dynamic document that reflects the Governing Board's plan for receipt of revenues and utilization of expenditures to meet the goals and financial obligations of the school district in the coming year based on the information known to the district and board at the time of adoption. To assure that the budget continues to reflect that plan, the following items should be taken into consideration:

UNRESTRICTED DEFICIT SPENDING TRENDS – The district is projecting unrestricted expenditures to exceed unrestricted revenues by \$7,715,119 in the current fiscal year, primarily due to a high salaries and benefits ratio, uncapped health and welfare benefits, and other ongoing operational costs. The district is continuing this trend of deficit spending in fiscal year 2014-15 by \$1,946,383 and in fiscal year 2015-16 by \$1,686,148. This ongoing 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. Ongoing deficit spending will cause an even greater reliance on district cash reserves.

The district did not include any funding increases pursuant to LCFF. The funding increases projected will likely offset at least a portion of the district's deficit spending shown on the district's Multiyear Projection (MYP). Once the district's budget is revised to include LCFF funding and any other changes that have occurred since the State Budget was enacted, it will be able to present a clearer picture of its financial position. Unidentified reductions included on the MYP of any future reports will not be considered in our review of the district's financial position or certification status.

The district's deficit spending is **not** within the established state standards for the current and second subsequent fiscal year. The State's established standard is one-third (1/3) of the district's available unrestricted reserve percentage.

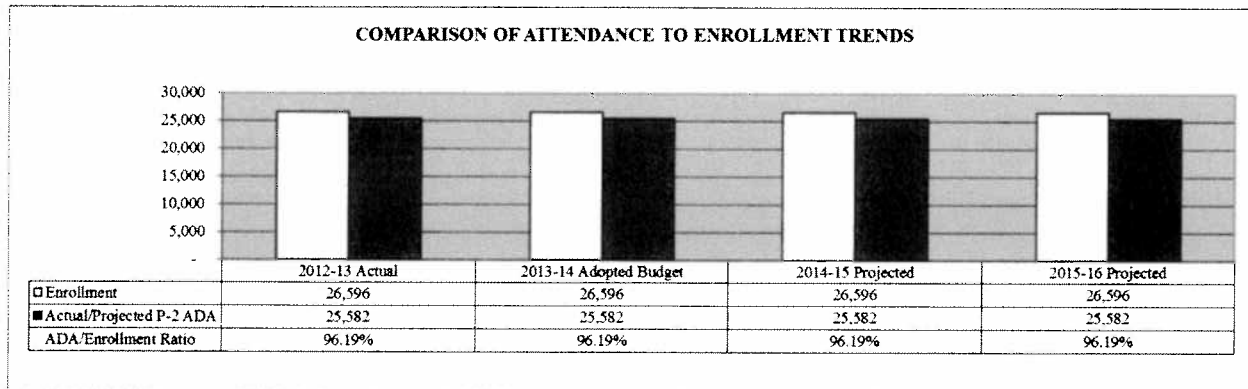
The following chart displays the actual Unrestricted General Fund balance change for the prior fiscal year, the projected adopted budget, and board approved multi-year financial projections reflecting the 2014-15 and 2015-16 fiscal years.



- AVERAGE DAILY ATTENDANCE (ADA) & ENROLLMENT PROJECTIONS** – The district is projecting 2013-14 P-2 ADA of 25,582 or no change over prior year P-2 ADA. The district’s three-year average change in ADA has been a decline of 0.06%. Compared to the enrollment projection of 26,596, the district is anticipating an attendance ratio of 96.19% for the current year. The district is projecting no change in ADA, enrollment, and attendance ratio for 2014-15 and 2015-16.

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 96.5% for each of those years. Although the district is projecting higher ADA than historical trends would indicate, the projection is based on ADA recovery rates that could be achieved through its Saturday School program. 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 reported ADA and enrollment in the 2012-13 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.



- **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.

The district has incorporated the lower deficit factor and COLA adjustments in the 2014-15 and 2015-16 fiscal years as estimated by the School Services of California’s (SSC) dartboard.

Our review of the district’s current and projected expenditures indicates \$5,798,458 of salary and benefit cost reductions were made in the 2014-15 fiscal year. The assumptions indicate that these reductions are non-negotiable, have been approved by the Governing Board, and represent a reduction of 46 certificated FTE, 75.375 classified FTE, and 16 management and confidential FTE. The district is currently maintaining a 180-day school year.

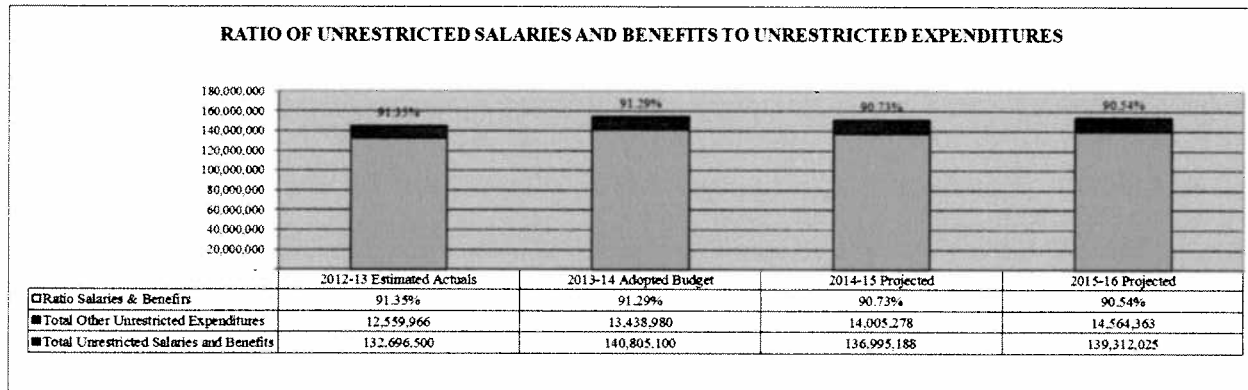
- **NEGOTIATIONS STATUS/SALARIES AND BENEFITS TRENDS** – The information submitted with your Adopted Budget indicates that salary negotiations have not been concluded with the classified bargaining unit for the 2012-13 fiscal year and have not been concluded with either bargaining unit for the 2013-14 fiscal year. The documents also indicate that there are no potential increases included in the adopted budget or subsequent fiscal years other than annual step and column advancements. Additionally, the district has included in the assumptions for future years, an estimated increase in health benefit costs of 5%, 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 AB 1200/2756 (GC 3540 et. seq.), please provide an analysis and disclosure of the costs or savings associated with any proposed or tentative agreements and/or Memoranda of Understanding (MOUs) **at least ten days prior to adoption by the board**. This analysis is required to be publicly disclosed at a board meeting regardless of whether there is an increase, decrease, or no change in expenditures or language. Budget transfers implementing the adjustment(s) must also be posted in 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.

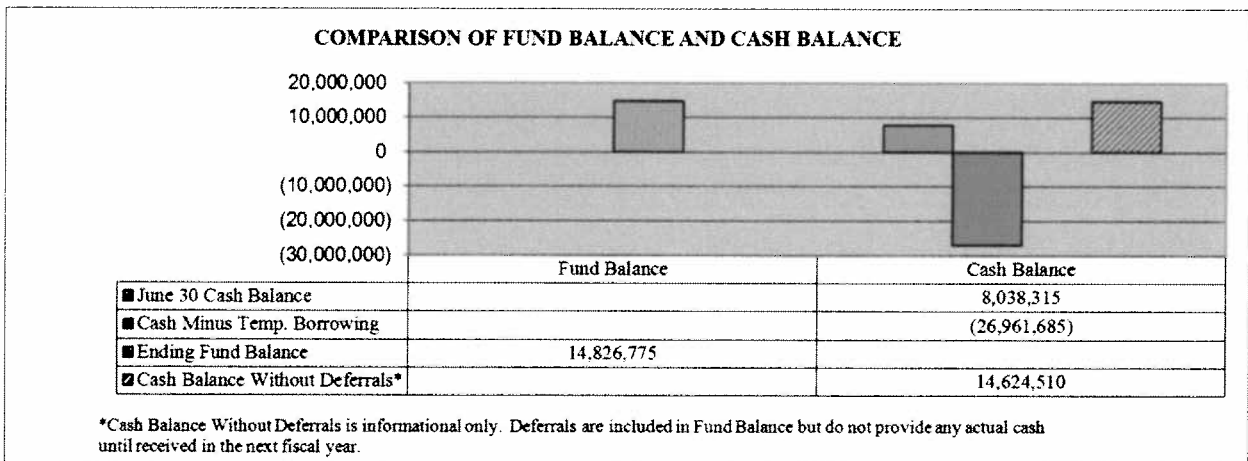
An outline of the disclosure procedures and a copy of the required disclosure documents are available in an EXCEL format on the San Bernardino County Superintendent of Schools, Business Administrators website (http://www2.sbcss.k12.ca.us/sbcss/busServe/bas_FormFI.php), under AB1200/AB2756 Salary disclosure. Instructions for completing these forms are also available on the website.

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, adopted budget, 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, when unidentified reductions shown on the MYP are considered as salary reductions pursuant to FTE reductions discussed previously. **However, the district’s high ratio of 91.3% carries a great deal of risk to future fiscal solvency. With the significant change to the school funding model brought about by LCFF, the yet unknown level of accountability, maintenance of effort requirements, and no guarantee of future funding increases, districts need to build a level of flexibility with contingency plans and greater reserves. With a significant amount of the district’s**

expenditures committed to salaries and benefits, its ability to build reserves and develop contingency plans is limited, and this limitation carries greater risk. We recommend that the district monitor this ratio and consider it as part of collective bargaining negotiations and oversight of position control.



- LONG TERM DEBT** – The 2011-12 Audit Report includes non-voter approved long-term debt of \$25,060,642, which constitutes 11.47% of the district’s general fund budget. The debt repayment is budgeted in the General and Child Development 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.
- CASH FLOW** – Our review of the 2013-14 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. The district’s cash flow shows the June 30 cash balance is estimated to be 54.2% of the projected 2013-14 Ending Fund Balance including any cross-year temporary borrowing. With cross-year temporary borrowing excluded, the district’s cash balance would be approximately -\$27M. To maintain a positive cash position, the district used Tax Revenue Anticipation Notes (TRANS) of \$12.453M, which is scheduled to be repaid in January 2014, and a projected \$35M, which would need to be repaid by August 2014 if borrowed.



Additionally, the district’s revenue limit is computed to be 5.7% Property Taxes and 94.3% State Aid, which means your district will realize a greater loss of cash due to state deferrals than a higher property

tax district. Although the state has reduced the amount of deferrals, our projections indicate that the state will defer approximately \$21M of the district's 2013-14 state aid into the 2014-15 fiscal year. The district will need to continue to monitor cash on a monthly basis to ensure that sufficient cash is available to cover operational costs. A good cash projection will allow the district to schedule expenditures in months when adequate cash will be available and plan for temporary borrowing as necessary.

- **FUTURE RISKS** - The 2013-14 State budget significantly changes the way school districts are funded. In addition, the State budget imposes a new set of accountability measures on districts while removing most restricted categorical programs along with their each individual compliance and accountability measures. This significant change brings with it risks. Some of the risks are continuous in nature, barring no future revisions of the law, while some may be short term in nature depending on how the changes will be implemented.

These risks are significant. A district's ability to mitigate these risks will depend on the flexibility that exists in its financial structure. If a district's financial structure is such that it has significant entanglement, meaning that it takes time to redirect financial resources, the greater the risk of fiscal insolvency.

The current risks that could have a significant impact on the District's fiscal wellbeing are as follows:

1. The new funding mechanism known as LCFF does not include any guarantees that districts will receive funding equivalent to the annual COLA.
2. The LCFF does not include any guarantees that future Legislatures/Governors will fund the LCFF at the proposed target level, or at any level of increase.
3. The rules regarding how districts must spend the supplemental and concentration grants have yet to be developed. At this time, the extent of any restrictions or flexibility in the use of these funds is unknown.
4. The full impact of Federal sequestration is unknown at this time. The estimate is that as of July 1, 2013, all programs will see a reduction from 2012 funding levels.
5. The elimination of the revenue limit as the funding mechanism removed certain expenditures protections.
 - a. Under the revenue limit model, districts enjoyed a level of stability in the cost of CalPERS retirement premiums. The cost to an district could not exceed 13.2%. If CalPERS exceeded a rate of 13.2%, the State picked up the difference. If the CalPERS rate was less than 13.2%, the State captured the difference. With the implementation of the LCFF, that protection no longer exists. Districts will now be responsible for the entire costs of CalPERS retirement premiums whether they increase or decrease. Given the adjustments to the CalPERS fund's asset smoothing and amortization methods aimed at improving the funded status of the retirement program, districts can expect significant increase retirement premiums in the future.
 - b. The revenue limit model protected districts from fluctuations in the Unemployment Insurance contribution rates. All districts were held at their 1975-76 actual Unemployment Expenditures. This protection no longer applies in the LCFF model. All increases in the Unemployment Insurance contribution rate since 1975-76 immediately impacts the District, including any increases in future years. In addition, districts will

experience constant fluctuation in their expenditures as the rate increases and decreases in future years.

6. At this time, the cost impact of the Affordable Care Act (ACA) is still unknown. As the Federal Government continues to work out the regulations attached to the law more information and the ability to determine current and future costs will be possible. Currently, the survival of the law is uncertain. What is known at this time is that the reform has not bent the cost curve downwards as it was projected it would. Instead, premiums have increased significantly and if we anticipate that they will continue to sharply increase in the future. If the law survives, these future costs will be borne by the District, regardless of whether the District receives any increase in funding under the LCFF, or not.
 7. According to CalSTRS, in order to fund fully the retirement program within thirty years, additional contributions of 17.2% will be required. CalSTRS and the Legislative Analyst Office (LAO) are urging the Legislature to enact a funding plan by the end of the 2014 legislative session. If that occurs, districts will start seeing an increase in their CalSTRS premium costs starting in 2014-15.
- **STATE ENACTED BUDGET – 45 DAY REVISION** – Our review has been based on the latest information available to this office with the 2013-14 State Enacted Budget. Please remember that Education Code Section 42127(i)(4) requires that:

“Not later than 45 days after the Governor signs the annual Budget Act, the school district shall make available for public review any revisions in revenues and expenditures that it has made to its budget to reflect the funding made available by that Budget Act”.

The 45-day period ends August 12, 2013. We will require these revisions in the 2012-13 Unaudited Actuals submission, which is due to our office per Education Code § 42100 on or before September 16, 2013. Please submit a narrative of all changes made to the 2013-14 Adopted Budget.

CONCLUSION - We are all breathing a sigh of relief in this first year where we are experiencing new revenues instead of revenue cuts. While we are all eager to begin restoring those programs that took a hit in these past years of revenue cuts, we must still be cautious. While the passage of Proposition 30 brought good news to the public, we in K-12 schools know that in reality the financial picture and outlook remain tenuous.

These remain difficult economic times as any recovery has been slow, and the outlook on continual growth is not necessarily optimistic. Adding to the slow economic recovery are the unknowns as listed in the future risk section of this letter. Consider that two of the big reforms, LCFF and ACA, of our time remain unfinished as the task of finalizing the details have been delegated to the bureaucracies. With so much of our expenditure components remaining undefined, these remain extraordinarily tough times to plan our future finances in a manner that is prudent and responsible. Therefore, it is important during these times that school districts stay proactive and cautious by developing budgets and contingency plans that allow the most flexibility in resource allocation as possible so that they can quickly react to unexpected decreases in revenues and/or unexpected increases in expenditures.

We anticipate a timely year-end closing of the 2012-13 financial records by the district, along with the annual audit by the district's external auditors, which will determine the actual beginning fund balances for 2013-14 and audited ending balances for 2012-13. These actions will also ultimately affect the availability of reserves for the 2013-14 operating budgets. The audit report is due on or before December 16, 2013.

Any questions concerning the review of the district's 2013-14 Adopted Budget may be addressed to me at (909) 386-9680.

Sincerely,



Thomas G. Cassida Jr., MBA
Business Services Advisor
Business Advisory Services

TGC:ls

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

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