November 13, 2012

To: Superintendents and Chief Business Officials

From: Garry P. Bousum, Associate Superintendent, Finance and Business Services

Subject: Background and Advice on the 2012-13 First Interim Report

This memorandum provides guidance and technical information regarding the completion of your 2012-13 First Interim Report and Related Multi-Year Projections (MYPs). The advice contained in this version incorporates the Enacted State Budget (AB 1464, Chapter 21, Statutes of 2012), the Education Trailer Bill (SB 1016, Chapter 38, Statutes of 2012) and other changes (including the approval of Proposition 30 on the November 6 General Election) since the "Background and Advice on the Enacted 2012-13 State Budget," which was issued on July 27, 2012.

BACKGROUND

On June 27, 2012, Governor Brown signed the 2012-13 Enacted State Budget (AB 1464, Chapter 21/2012) and the Education Trailer Bill (SB 1016, Chapter 38, Statutes of 2012). This Budget closed a budget deficit of $15.7 billion and rebuilds a $948 million reserve. The final Budget contained $16.640 billion in total solutions including $8.089 billion in additional expenditure reductions, $6.033 billion in increased revenues (primarily from temporary taxes), and $2.518 billion in "other miscellaneous solutions" (borrowing, new fees and interest payments).

The cornerstone of this budget assumed passage of a new tax initiative proposed by the Governor, named the, "Schools and Local Public Safety Protection Act of 2012", Proposition 30 was approved in the November 2012 General Election. The final 2012-13 Budget assumed the initiative would generate $8.5 billion in 2012-13. According to the Legislative Analyst's Office (LAO), the initiative will generate an additional $6.8 - $8.5 billion in 2013 and $5.4 - $7.6 billion for each year thereafter through 2018. This initiative temporarily increases the state sales tax by 0.25% until the end of 2016 and increases the income tax rate by up to 3% on the state's wealthiest taxpayers until it expires in 2018. Although Proposition 30 was approved by voters, school districts need to recognize that there is no new programmatic funding for schools, the tax increases are temporary, and we are still funded significantly below 2007-08 levels. Additionally, Proposition 30 requires that funds generated be placed in the Education Protection Act (EPA) Account and has some restrictions on usage of funds. California Department of Education (CDE) is currently analyzing the requirements and will provide guidance prior to the 2012-13 Second Interim Report.

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Cash management remains critical for school districts. School districts, charter schools and county offices of education will have less cash in 2012-13 for the period January through May 2013 than they received in 2011-12. Please read the Cash Management section of this memorandum very carefully.

In Governor Brown's Budget Act signing message, he reiterated his commitment to a balanced budget that prioritizes education as a core public service: "This budget reflects tough choices that will help get California back on track. I commend the Legislature for making difficult decisions, especially enacting welfare reform and across-the-board pay cuts. My revenue proposal is fair and temporary. Our state budget problem was built up over a decade, and it won't be fixed overnight. These temporary increases will ensure funding for our schools until the economy improves."

The 2012-13 Enacted State Budget increased the K-14 (Proposition 98) spending by about $6.7 billion. The 2011-12 K-14 (Proposition 98) spending was $46.9 billion, but was increased to $53.6 billion in 2012-13. **However, the enacted budget essentially maintains programmatic funding in 2012-13 at prior year levels.** The K-12 (Proposition 98) increases were used as follows;

- $2.1 billion (K-12) to fund the 2011-12 deferral in 2012-13.
- $2.065 billion (K-12) to pay down the cross fiscal year deferral credit card already on the books. K-12 cross fiscal year deferrals would be reduced from $9.5 billion to $7.4 billion in 2012-13.
- $98.6 million increase in Special Education funding for mental health services to disabled students that backfills one-time Proposition 63 funding used in 2011-12.
- $450 million in funding for the Quality Education Investment Act (QEIA) included inside Proposition 98 spending guarantee for one-year.
- $86.2 million increase in funding for K-12 mandates.
- $53.7 million increase for charter school growth.
- $183 million increase for Transitional Kindergarten.
- $163.9 million increase to shift the Title 5 part-day center-based child care services into the State Preschool program.

"TRIGGER LANGUAGE"

The Enacted State Budget provided for 2012-13 "trigger reductions" of $5.354 billion to K-14 education should the Governor's tax initiative not pass on the November 2012 election. Since the initiative passed, Education Code 46201.4 will now be inoperative. This means there will be no mid-year reduction to the revenue limit which was estimated to be approximately $441/ADA for an average unified school district. In addition, the flexibility for school districts to reduce the school year (or the equivalent number of instructional minutes) by up to 15 more days in 2012-13 and 2013-14 becomes inoperative. The allowed reduction reverts to the 5 days currently in law (175 day year).

MONTEREY COUNTY OFFICE OF EDUCATION GUIDANCE

Based on the fiscal realities that affect school districts, we recommend the following guidance:

- It is expected that school districts will maintain "best fiscal practices." Our advice to school districts is that you should continue with prudent fiscal management.
- Contingency plans must be realistic.
- Carefully review your MYPs for one-time revenues and note the ending date of the revenues to avoid over projecting those revenues.
- Cash flow becomes a critical consideration. Your district may find it more difficult to issue TRANs and the cost of any borrowing may increase. We recommend that cash flow should be looked at over an 18-month cycle rather than a 12 month cycle.
- Recognize that Proposition 30 revenues are temporary: the sales tax increase expires at the end of 2016 and the income tax increase expires in 2018.

THE FOLLOWING SECTIONS PROVIDE MORE DETAILED ADVICE RELATIVE TO CHANGES SINCE THE 2012-13 ENACTED BUDGET GUIDANCE DATED JULY 27, 2012:

Revenue Limit and COLAs

The Enacted State Budget did not provide a statutory cost of living adjustment (COLA) for any program in 2012-13. The actual statutory COLA of 3.24% is not funded; therefore, the deficit factor will be increased to reflect this loss of funding. The budget provides funding of $169 million in 2012-13 for enrollment growth.

It is recommended that school districts use the following COLAs and deficit factors when updating the 2012-13 First Interim report and multi-year projections:

	2012-13	2013-14	2014-15
Statutory Cost of Living Adjustment (COLA)	3.24%	2.00%	2.30%
Recommended COLA	0.00%	0.00%	2.30%
K-12 Deficit	22.272% (.77728)	22.272% (.77728)	22.272% (.77728)

Although unfunded, the 3.24% statutory COLA for 2012-13 and the estimated COLAs for 2013-14 and 2014-15 translate into the following statewide average base revenue limit amount per ADA:

School District Type	2012-13 Enacted State Budget Statutory COLA 3.24%	2013-14 Estimated Statutory COLA 2.00%	2014-15 Estimated Statutory COLA 2.30%
Elementary	$202	$129	$151
High School	$243	$155	$182
Unified	$212	$135	$158

The following are factors to be considered as a school district calculates its 2012-13 revenue limit;

- The 3.24% statutory COLA is not funded for 2012-13.
- The 0.848% or average of $55/ADA revenue limit "trigger reduction" was implemented beginning in February 2012 for fiscal year 2011-12 only.

The School Services of California Financial Projection Dartboard provides additional information relative to statutory COLAs and revenue limit deficits. **It is recommended that school districts utilize this information in preparing their Multi-Year Projections (MYPs). Given the uncertainty of the State's economic recovery, your school district should have a contingency plan for any reduction to the out year COLAs when incorporating future statutory COLAs.**

Basic Aid School Districts

Beginning with ABX4 2 (Chapter 2/2009), basic aid districts have been subject to "fair share" reductions. A basic aid district's "fair share" reduction is calculated against their total revenue limit funding subject to deficit. This amount is then taken from categorical revenues to the extent that categorical revenues are available, including AB602 Special Education revenues and State mental health funding. Only the following three categorical programs are exempt from the reduction: After School Education and Safety (ASES program), Quality Education Investment Act (QEIA) and Child Care and Development. Also, the

Department of Finance has stated that any amounts received from the Mandate Block Grant are not subject to any fair share reductions.

The “fair share” reduction is 9.57% in 2012-13, and will be 8.92% in 2013-14 as a result of SB 81, which shifted the mid-year transportation “trigger” reductions to a one-time revenue limit reduction, including one-time “fair share” reductions for basic aid districts.

Historically, a school district receives a “fair share” reduction if the district was basic aid in the prior year. However, in no event would that reduction be more than the amount of local property tax revenues that exceed the district’s revenue limit. ABX4 2 also specified that the reduction shall not violate the constitutional funding requirement that the state provide $120 per ADA or $2,400 per school agency, whichever is greater.

It is important for basic aid districts to carry higher than minimum reserves. Dependency on property taxes means dependency on assessed property values. Greater than minimum reserves provide a buffer in the event that assessed values fall short of projections. Due to the continuing economic uncertainties and its impact on assessed values, reserves are more critical than ever before. Moreover, basic aid districts whose student population is growing do not receive additional funding. For these reasons and the growing loss from “fair share” reductions, higher than minimum reserves are important.

Special Education

The Enacted State Budget for special education provided no additional statewide funding for ADA growth and left the appropriation at the 2011-12 level. No COLA is provided for special education.

- Special Education Local Plan Areas (SELPAs) with growth are expected to receive an estimated $465.44 per ADA. This is the same as last year. This will be recaptured from SELPAs that are declining in ADA.
- Also, a $17.4 million increase in federal funding will be allocated to SELPAs, estimated at $2.94 per ADA.
- Under current law, school districts need to meet maintenance of effort (MOE) requirements irrespective of any reduced work or school year.

AB 3632 mental health services to students with disabilities continue to be the responsibility of school districts for 2012-13. A total of $420 million was provided to support mental health services including the $98.6 million augmentation to backfill the loss of the Mental Health Act funding (Proposition 63).

The Mental Health funding formula for the distribution of the $420 million will be allocated as follows:

- $348.1 million will be allocated from Proposition 98 funds and is estimated at $58.40 per ADA.
- For the 2012-13 year only, there will be a one-year phase-in of mental health services funding to SELPAs as follows:
    - Twenty-five percent (25%) or $17.2 million of the $69 million in federal IDEA Mental Health funds will be allocated based on ADA estimated at $2.83 per ADA.
    - Seventy five percent (75%) or $51.7 million of the $69 million in federal IDEA Mental Health funds will be allocated using the December 2010 CASEMIS student data (Note: This will convert to ADA in 2013-14)
- $3 million is provided in an extraordinary cost pool for necessary small SELPAs.

Also note that the Behavioral Intervention Plan (BIP) mandate was not repealed or modified. It is recommended that school districts keep expenditure documentation for this program pending a decision by the Commission on State Mandates.

The Governor vetoed all state funding ($15 million) for the Early Mental Health Intervention (EMHI) program as proposed by the Legislature.

Federal Sequestration

In August 2011, Congress passed the Budget Control Act. This legislation directed a Congressional "Supercommittee" to trim federal spending by at least $1.2 trillion over the next decade. The Supercommittee's failure to present a specific program of spending reductions triggers automatic cuts through a process known as sequestration which applies an across-the-board percentage cut to most federal spending streams, including funding of most federal education programs.

On July 20, 2012, the United States Department of Education (USDE) sent a memorandum to state chief school officers outlining the action the USDE will take if Congress does not act to reach a deficit reduction plan and avoid sequestration by January 2, 2013.

In September 2012, the Office of Management and Budget released a report that identifies approximately $100 billion in cuts that would be imposed on most federal programs on January 2, 2013, if Congress is unable to reach an agreement to make targeted cuts. This includes 52 separate Federal programs with the largest program being Title 1 and IDEA. Programs that were excluded include anything related to: American Recovery and Reinvestment Act (ARRA), Education Jobs, Child Nutrition, and Child Care. For Local Educational Agencies (LEAs), this equals approximately an 8.2% reduction in funding for these programs. The report can be found at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

LEAs should develop contingency plans for these federal sequestration cuts that could impact budgets for 2013-14, with the exception of Impact Aid which would become effective during 2012-13.

Transportation

The Education Trailer Bill (Chapter 38/2012) allocated $618 million in transportation funding for 2012-13. School districts will receive the funding as a restricted transportation apportionment. The funds are not flexible. The current education code restrictions on its use and the requirements to maintain a minimum level of transportation services are still in force.

Child Care and Preschool Programs

The Enacted State Budget made significant changes to child care and preschool programs. The budget achieved $294.3 million in non-Proposition 98 savings and included the elimination of 14,000 child care slots. Following are specific reductions and savings:

- Shifting all of Title 5 part-day, part-year center-based preschool programs into the State Preschool program (Proposition 98) to achieve $163.9 million in general fund savings (partially offset by a new requirement to collect family fees).
- Requiring fees to be assessed and collected for families with children in part-day preschool programs, families receiving wraparound child care services, or both.
- Providing an 8.7% across the board reduction to the General Child Care Program, Migrant Day Care Program, Alternative Payment Program, CalWORKs Stage 3 Program, and Allowances for Handicapped Programs. Achieves $100 million in savings.
- Suspending the cost of living adjustments (COLA) for child care and development programs for fiscal years 2012-13, 2013-14, and 2014-15. Achieves $30 million in savings starting in 2013-14.
- Aligning state preschool eligibility to new kindergarten cutoff dates. Specifically, defines that state preschool programs are to facilitate the transition to kindergarten for 3- and 4-year old children who have their 3rd or 4th birthday, respectively, on or before November 1 of the 2012-13 fiscal year, October 1 of the 2013-14 fiscal year, and September 1 of the 2014-15 fiscal year of each fiscal year thereafter.
- Providing that for 2012-13, the family fee schedule for child care and development services in effect for 2011-12 shall remain in effect, and continues existing policy that the family fees cannot exceed 10 percent of the family's total income.

Quality Education Investment Act (QEIA)

The Education Trailer Bill (Chapter 38/2012) moved the final year of the QEIA program from 2013-14 to 2014-15. This is accomplished by clarifying that the original funding for QEIA was provided by Assembly Bill 3 of the Fourth Extraordinary Session (ABX4 3) (Chapter 3/2009-10) and ABX3 56 (Chapter 31/2009-10).

There are no changes to the current funding rates. For 2012-13 the rates continue to be:

- $500 per enrolled pupil for kindergarten and grades 1-3
- $900 per enrolled pupil Grades 4-8
- $1,000 per enrolled pupil Grades 9-12

QEIA is funded within Proposition 98 in 2012-13. The change is a result of an over appropriation to Proposition 98 in 2011-12 and the subsequent 2012-13 budget act decision to pay $450 million for QEIA within Proposition 98. In addition to the $450 million from Proposition 98 funds for 2012-13, the budget act calls for $181 million in 2013-14 and $40.8 million in 2014-15 of Proposition 98 funding to be directed to QEIA.

Lottery

Please note that Lottery funding will be calculated in the same manner as prior years, with the exception that through 2014-15, the following programs will be funded based on 2007-08 ADA rather than the prior year ADA:

- Adult Education
- Regional Occupational Center and Programs (ROC/P)

On April 8, 2010, the Legislature passed AB142 (Chapter 13 / 2010) which requires that not less than 37% of the total annual revenues from the sale of lottery tickets be distributed to education.

The estimates for 2012-13 are $124.00 per annual ADA (unrestricted) and $30.00 per annual ADA (Prop. 20 restricted).

Mandated Costs

The Enacted State Budget provided $166.6 million to create a Mandate Block Grant (MBG) funding allocation for K-12 school districts, Charter Schools and County Offices of Education. Funding is based on 2011-12 P2 ADA for specific categories of ADA and is $28/ADA for school districts, and $14/ADA for Charter Schools for 2012-13. Participation in the block grant waives the existing claiming process for the mandates contained in the block grant. This provides that all Local Education Agencies (LEAs) are reimbursed at the same rate for providing services for the same mandated requirements. All LEAs are subject to compliance audits. The State Controller's Office (SCO) had indicated there will not be any new audit requirements for the MBG for this year. Detailed information including the mandates included in the Mandate Block Grant (Assembly Bill 1016, Statutes of 2012) program can be found at http://www.cde.ca.gov/fg/aa/ca/mandatebg.asp.

SB 1028 (Chapter 575, Statutes of 2012), which was signed into law by Governor Brown on September 26, 2012, added five K-12 mandates to the MBG that were previously excluded. Those five mandates are:

1. Academic Performance Index
2. Child Abuse and Neglect Reporting
3. Expulsion of Pupil: Transcript Cost for Appeals
4. Interdistrict Attendance Permits
5. Student Records

School districts also have the option to decline the MBG funding and continue to claim reimbursements under the existing mandate claims process with the same mandate requirements.

School districts are allowed to annually choose either the MBG funding or funding through the traditional claims process. School districts need to elect to participate in the MBG by September 30 of each year. Note that for those mandates not part of the MBG program, claims may be submitted under the current claiming format. The mandates not included in the MBG are:

1. Graduation Requirements
2. New Developer Fees. Instructions for filing claims can be found on the SCO's web site at the following web link: http://www.sco.ca.gov/Files-ARD-Local/Instructions/sd_1112_df333.pdf
3. Teacher Incentive Program
4. Behavioral Intervention Program

The mandates suspended in 2011-12 will continue to be suspended in 2012-13. No additional mandates were suspended for 2012-13.

Forest Reserve Funds

On July 6, 2012, the President signed, via language included in Public Law 112-141, a one year only extension of the Secure Rural Schools and Communities Act (SRSCA). California is expected to receive approximately $37.8 million for the 2012 year. This is approximately 4% less than prior years funding. Specific allocations for individual counties can be found at http://www.fs.usda.gov/main/pts/securepayments/projectedpayments.

Transitional Kindergarten

SB 1381, Chapter 705, Statutes of 2010 changed the birth date for enrollment in kindergarten by moving the date for eligible age requirement from December 2nd to September 1st. Under current law these changes are scheduled to be phased in over three years as follows:

- Eligibility by November 1 for 2012-13
- Eligibility by October 1 for 2013-14
- Eligibility by September 1 for 2014-15

This bill mandated a Transitional Kindergarten Program for students displaced as a result of the changes in eligibility birthdates. School districts are currently eligible to collect ADA for these transitional kindergarten students. Under current law, school districts may not receive ADA funding to serve a four year old unless that child has his or her fifth birthday according to the appropriate phase-in period noted above. Children admitted during the school year who do not meet the phase-in period criteria may only be enrolled on a case-by-case basis upon having attained the age of five.

The Transitional Kindergarten program is not required to be operated at every school site, just by the school district so it meets the needs of the school district.

The Transitional Kindergarten program is subject to the class size provisions and penalties as specified in Education Code 41378. Also, all Education Code provisions which apply to kindergarten students also apply to transitional kindergarten students.

The Enacted State Budget did not repeal the Transitional Kindergarten requirements. Therefore Transitional Kindergarten is required beginning with 2012-13. School districts must implement Education Code 48000(b) as it currently reads.

Expansion of Categorical Flexibility and Tier III Public Hearing Requirements

The Enacted State Budget made no changes to the current Tier III flexibility provisions or the programs placed in Tier III.

Please note that most of the temporary flexibility provisions were extended to June 30, 2015 with the exception of the K-3 Class Size Reduction (CSR) reduced penalty provisions. The flexibility provisions for the CSR reduced penalties expire on June 30, 2014 instead of June 30, 2015. This would impact the school district MYPs.

Advancement Via Individualized Determination (AVID)

The state budget submitted to the Governor proposed to fully fund $8.1 million for AVID. However, the Governor vetoed the funding.

Charter Schools

The Enacted State Budget included an increase of $53.7 million for the Charter School General Purpose Block Grant and Categorical Block Grant.

The General Purpose Block Grant rates are based on statewide average revenue limits (Education Code 47633(a)). The rates listed below are based on the CDE 2011-12 P2 Certification. CDE will recalculate these rates at the 2012-13 P1 Certification. The CDE recalculates the General Purpose rates at each apportionment. The Categorical Block Grant rate reflects flat funding for 2012-13. The estimated rates for 2012-13 are (based on 2011-12 P2 Certification):

	K-3	4-6	7-8	9-12
General Purpose Block Grant	$5,076	$5,153	$5,308	$6,141
Categorical Block Grant	$400	$400	$400	$400
Total	$5,476	$5,553	$5,708	$6,541

Charter schools can elect to receive mandate reimbursements at $14 per ADA. They are subject to the same compliance requirements as school districts.

The Enacted State Budget contained the following additional changes for charter schools:

- The Education Trailer Bill (Chapter 38/2012), in Section 37.1 and 37.3, requires the governing board of any school district seeking to sell or lease any real property designed to provide direct instruction or instructional support it deems to be surplus property to first offer that property for sale or lease to any charter school that has submitted a written request to the school district to be notified of any surplus property offered for sale or lease by the school district. The bill outlines in detail the process for how a purchase or lease, and under what terms, the sale or lease of school property would take place. This applies to surplus property identified after July 1, 2012 and is in effect through June 30, 2013.
- Authorizes County Boards of Education, subject to the concurrence of the County Superintendent of Schools to loan moneys from the proceeds of Revenue Anticipation Notes to charter schools.
- Allows all new and existing non-classroom based charters to receive full funding without needing State Board of Education review and approval and would eliminate the funding determination process and will ultimately allow all non-classroom based charters to receive full funding.
- Authorizes county treasurers to lend to charter schools.
- Charter schools are now authorized to receive the proposed mandate block grant at the rate of $14/pupil.
- Establishes charter schools as a local agency for the purpose of issuing Tax and Revenue Anticipation Notes (TRANs).
- Authorizes charter schools to directly seek an exemption from the intra-year deferrals and requires the charter school authorizer be notified of the request.

CASH MANAGEMENT

<u>In these challenging times, school district cash management is extremely important and the margin for error is razor thin. In 2012-13 SCHOOL DISTRICTS MUST MANAGE a $6.92 billion entitlement reduction that won't be paid back until June 2013. SCHOOL DISTRICTS NOW BENEFIT FROM a buy down of approximately $2.065 billion in cross fiscal year deferrals.</u>

The 2012-13 budget assumed the passage of Proposition 30 and included a $6.92 billion entitlement reduction that began in July 2012. Since Proposition 30 was successful, the State will pay back the $6.92 billion entitlement reduction by June 30, 2013. However, if the Proposition 30 tax revenues do not generate the full $6.92 billion by June 30th, the difference will be paid in July 2013 with the 2012-13 P-2 apportionment.

Because of the way the $6.92 billion entitlement reduction was applied to LEAs, the impact on cash flow is unique for each LEA. The total percent of cash received by June 30, 2013 will be different for each district. We encourage LEAs to use the CDE's principal apportionment payment calculator for projecting cash receipts for the period of February 2013 through August 2013. The payment calculator can be accessed by visiting: http://www.cde.ca.gov/fg/aa/pa/documents/papaycalculator2012.xls.

Intra-Year Principal Apportionment Deferrals

AB 103, chaptered on May 23, 2012, established intra-year principal deferrals for 2012-13 (see table below).

Timeframe	2012-13 Intra-Year Deferrals (AB 103)
July 2012 to September 2012	$700 million
July 2012 to January 2013	$500 million
August 2012 to January 2013	$600 million
October 2012 to January 2013	$800 million
March 2013 to April 2013	$900 million

Cross Fiscal Year Principal Apportionment Deferrals

As a result of the passage of Proposition 30, cross fiscal year deferrals will be reduced by $2.065 billion. Please see Attachment B for a graphic illustration of statewide principal apportionment deferrals.

Timeframe	2012-13 Cross Fiscal Year Deferrals
February 2013 to July 2013	$532 million
March 2013 to August 2013	$1.029 billion
April 2013 to August 2013	$763.8 million
April 2013 to July 2013	$419 million
April 2013 to July 2013	$175.6 million
May 2013 to July 2013	$800 million
May 2013 to July 2013	$1.177 billion
June 2013 to July 2013	100% of the June apportionment, which has been $2.5 billion in prior years
Deferred across fiscal years	**$7.4 billion**

We recommend the following next steps to analyze the effects of Proposition 30:

- Immediately revise 2012-13 and 2013-14 cash flow projections to reflect the entitlement reduction payment in June 2013 and the reduced cross fiscal year deferrals. Use CDE's principal apportionment payment calculator to help with this task.
  http://www.cde.ca.gov/fg/aa/pa/documents/papaycalculator2012.xls

- Evaluate cash flow projections as soon as possible and develop a plan of action to address cash shortfalls. Options include:
  - Temporary interfund borrowing (Education Code Section 42603)
  - Issue a cross fiscal year tax revenue anticipation notes (TRANs)
  - Request a temporary transfer from the county treasurer (Education Code Section 42620)
  - Request a temporary transfer from the county superintendent of schools (Education Code Section 42621)

RESERVE FOR ECONOMIC UNCERTAINTIES

The revised 2009-10 Enacted Budget lowered the minimum reserve requirement levels for economic uncertainties to 1/3 the percentage level adopted by the State Board of Education as of May 1, 2009. SB 70 extended this provision for both 2010-11 and 2011-12. However, school districts are required to make progress in the 2012-13 fiscal year to return to compliance with the specified standards and criteria adopted by the State Board of Education. By fiscal year 2013-14, school districts must meet compliance and restore the reserves to the percentage adopted by the State Board of Education as of May 1, 2009. We believe that the percentages established in the Criteria and Standards for reserves prior to the current Enacted Budget are the BARE MINIMUM. If a school district reduces the minimum reserve levels, it would take budget reductions of twice the amount of the lowered reserve levels to fully restore the reserve by June 30, 2014. With the continued deferral of apportionments, it is more critical than ever to maintain higher levels of reserves for cash flow purposes. A school district needs a state loan when they run out of cash and do not have any other borrowing options even if the school district has a positive fund balance.

Basic aid school districts are advised to maintain reserves much greater than the State required minimum because they do not have the prior year ADA protection provided to school districts under Education Code 42238.5, whereby revenue limit funding is based on ADA for either the current or prior fiscal year, whichever is greater.

NEGOTIATIONS

If considering a multi-year contract, school districts need to be very cautious and have appropriate contingency language that protects the school districts from cost increases beyond its control (i.e.: pension reform, health care reform and/or any weighted student funding formula).

Also, school districts should consider that the Proposition 30 sales tax expires at the end of 2016 and the income tax increase expires in 2018.

Any school district budget actions that require negotiated settlements may not normally be given credit for any settlement by the County Office of Education until negotiations are completed.

SUMMARY

We recognize that these are extraordinary economic times and it is difficult to gauge the future. School district budgets should be managed with an eye to the significant downside risk created by the State's ongoing structural deficit. In these times of great economic and budgetary uncertainty, school districts need reserves that are much greater than the minimum.

It is recommended that your school district continue to be cautious and focus on a multi-year strategy when recommending decisions and obtaining agreements. Attention should be focused on the multi-year projections for 2013-14 and beyond. School districts should develop financial projections and contingency plans accordingly.

We understand how difficult it is for school districts to deal with the increased pressures, significantly reduced funding, apportionment deferrals, and the uncertainty associated with the current economy. It is important that school districts be proactive to maintain their fiscal solvency through developing contingency plans that allow the most flexibility possible.

FCMAT Predictors of School Agencies Needing Intervention

The following 11 conditions represent those school agency problems most commonly encountered by the Fiscal Crisis and Management Assistance Team (FCMAT). The presence of any one condition is not necessarily an indication of a school agency in trouble. Unavoidable short-term situations such as key administrative vacancies can result in brief and acceptable periods of exposure to one or more of the following conditions. Exceeding acceptable limits of exposure in one or more of the following conditions is often the blueprint for districts nearing or presently in a crisis situation.

1. *Leadership Breakdown**
- a. Governance crisis**
- b. Ineffective staff recruitment
- c. Board micromanagement and special interest groups influencing boards
- d. Ineffective or no supervision
- e. Litigation against district

2. *Ineffective Communication**
- a. Staff unrest and morale issues
- b. Absence of communication to educational community**
- c. Lack of interagency cooperation**
- d. Breakdown of internal systems (payroll, position control)

3. *Collapse of Infrastructure*
- a. Unhealthful and unsafe facilities and sites
- b. Deferred maintenance neglected
- c. Low Budget Priority
- d. Local and state citations ignored
- e. No long-range plan for facility maintenance

4. *Inadequate Budget Development**
- a. Failure to recognize year-to-year trends, e.g., declining enrollment or deficit spending**
- b. Flawed ADA projections**
- c. Failure to maintain reserves**
- d. Salary and benefits in unrealistic proportions
- e. Insufficient consideration of long-term bargaining agreement effects**
- f. Flawed multi-year projections**
- g. Inaccurate revenue and expenditure estimations**

5. *Limited Budget Monitoring**
- a. Failure to reconcile ledgers
- b. Poor cash flow analysis and reconciliation**
- c. Inadequate business systems and controls
- d. Inattention to COE data
- e. Failure to review management control reports
- f. Bargaining agreements beyond state COLA**
- g. Lawsuit settlements

6. *Poor Position Control**
- a. Identification of each position missing
- b. Unauthorized hiring
- c. Budget development process affected
- d. No integration of position control with payroll**

7. *Ineffective Management Information Systems**
- a. Limited access to timely personnel, payroll, and budget control data and reports**
- b. Inadequate attention to system life cycles
- c. Inadequate communication systems

8. *Inattention to Categorical Programs**
- a. Escalating general fund encroachment**
- b. Lack of regular monitoring**
- c. Illegal expenditures
- d. Failure to file claims

9. *Substantial Long-Term Debt Commitments*
- a. Increased costs of employee health benefits+
- b. Certificates of participation
- c. Retiree health benefits for employees and spouse+
- d. Expiring parcel taxes dedicated to ongoing costs

10. *Human Resource Crisis*
- a. Shortage of staff (administrators, teachers, support, and board)
- b. Teachers and support staff working out of assignment
- c. Students/classrooms without teachers
- d. Administrators coping with daily crisis intervention
- e. Inadequate staff development

11. *Related Issues of Concern*
- a. Local and state audit exceptions
- b. Disproportionate number of under performing schools
- c. Staff, parent, and student exodus from the school district
- d. Public support for public schools decreasing
- e. Inadequate community participation and communication

* Highlights the seven conditions consistently found in each district requesting an emergency loan or dealing with a "fiscal crisis."

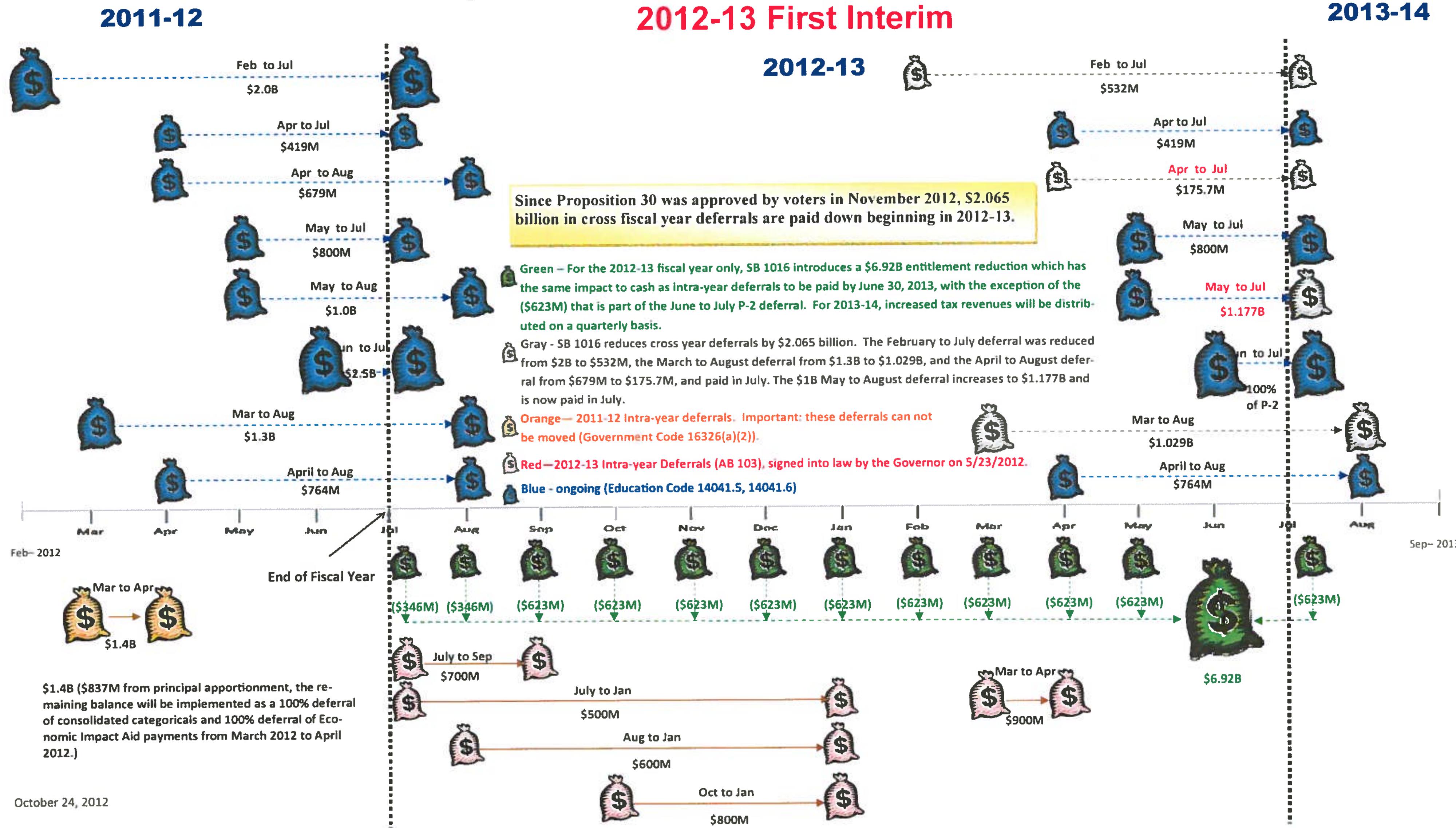
** Represents the 15 conditions that have been found most frequently to indicate fiscal distress and are those referenced in Assembly Bill 2756 (Daucher) and recently amended Education Code Sections 42127 and 42127.6.

\+ Indicates an emerging area of significant concern.

ATTACHMENT B

Delayed Principal Apportionment Funding

2012-13 First Interim



October 24, 2012