



SAN DIEGO COUNTY OFFICE OF EDUCATION

6401 LINDA VISTA ROAD, SAN DIEGO, CALIFORNIA 92111-7399 (858) 292-3500

Superintendent of Schools
Randolph E. Ward, Ed.D.

August 16, 2010

Mr. William Kowba, Superintendent
Mr. Richard Barrera, Board President
San Diego Unified School District
4100 Normal Street
San Diego, CA 92103-2682

Dear Mr. Kowba and Mr. Barrera:

Re: 2010-11 Conditional Approval of Budget and Comments

Our office has completed its review of the district's 2010-11 Adopted Budget in compliance with the provisions of Education Code Section 42127 et seq. The County Superintendent of Schools is required to review the adopted budget and determine if the budget: (1) meets the Criteria and Standards for fiscal stability; (2) allows the district to meet its financial obligations during the fiscal year; and (3) will enable the district to satisfy its multi-year financial commitments. The district's Adopted Budget has been analyzed in the context of the Governor's 2010-11 May Revise proposal.

Based on this analysis, we have concluded that the district budget does not provide adequate assurance that the district will meet its current and future financial obligations. The budget submitted shows that the district will be unable to meet its reserve requirement for 2010-11 and its multi-year financial commitments in 2011-12 and 2012-13 without additional budget solutions. The San Diego County Superintendent of Schools therefore conditionally approves the district's budget at this time pursuant to Education Code Section 42127(c)(2). Therefore, on or before September 8, 2010 the San Diego Unified School District's governing board shall:

- 1) Revise the adopted budget to reflect changes in projected income or expenditures subsequent to July 1, this would include any cuts required to meet the .67+% Reserve for Economic Uncertainty
- 2) Include any response to the recommendations of the county superintendent of schools,
- 3) Readopt the revised budget and submit it to the San Diego County Office of Education. (If the district is able to complete the Unaudited Actuals by the September 8, 2010 deadline, the district can readopt the budget at the same

Board of Education

Mark C. Anderson Susan Hartley Sharon C. Jones Jerry R. Rindone John Witt

SERVICE AND LEADERSHIP

- time that the district is approving the Unaudited Actuals and submit as one report.)
- 4) Approve resolution in Attachment A

This letter discusses our analysis on the district's budget. The resolution in Attachment A identifies the amount of budget reductions needed in future years and requires the district to submit a list of board approved budget reductions for 2011-12 and the district's timeline for implementation with the 2010-11 First Interim Report. This resolution will be considered to be a supplemental component of the district's revised adopted budget. Following receipt of the district's readopted budget and resolution, our office will send the district a letter stating whether the 2010-11 adopted budget will be approved or disapproved by October 8, 2010.

The district's budget will be reevaluated at the time of the First Interim Report to determine if the budget should be certified as positive, qualified, or negative. The county superintendent also has the authority to determine that a school district is "not a going concern" at any time during the fiscal year if the district may not meet its financial obligations for the current or two subsequent fiscal years [Education Code Section 42127.6(a)(1)]. Our office can take this action at any time if substantial progress is not made towards budget reductions.

During our review, we noted the following items for your review, analysis, and action:

Fiscal Status in 2009-10 and 2010-11

Budget Reductions Approved for 2010-11

In response to the proposed state budget reductions, the district has taken proactive steps to ensure continued fiscal solvency. The district has adopted \$104.3 million in ongoing and one-time budget reductions/solutions. This included a reduction of 31.5 certificated FTE and 89.18 classified FTE. The actual amount of savings will depend on how the cuts are implemented. We will periodically review revenues and expenditures to monitor the amount of savings achieved.

Special Disabilities Adjustment

The AB 602 Special Disabilities Adjustment (SDA) appropriation was included in the 2009-10 Budget, but the necessary statutory language to provide the authority to calculate and disburse the funds was not included in the budget trailer bill. CDE first apportioned these funds, but Legislation required by July to fix the problem was not enacted, therefore CDE took back the allocation from the affected SELPAs. Similar language is also required for 2010-11 in order for CDE to disburse the SDA funds. The San Diego Unified School District budgeted \$9 million dollars in 09-10 and each subsequent year through 2012-13.

Reserve for Economic Uncertainties

The state requires the district to maintain a Reserve for Economic Uncertainties equal to 2% of expenditures. We believe that this level represents the minimum reserve level that a school district should maintain. However, EC § 33128.3 allows school districts to reduce the reserve to one-third of this requirement for 2009-10, which is .67%. A school district must make progress in 2010-11 toward returning to the original reserve requirement. In 2011-12, the full reserve requirement of 2% must be met. The district projects that it will meet this requirement in 2009-10. However, due to the Special Disabilities issue previously discussed, the district will have a .44% reserve in 2010-11. Therefore, the district does not meet the reserve requirement in 2010-11.

Deficit Spending

The district is projecting deficit spending in its Unrestricted General Fund of \$38.2 million in 2009-10 and \$35.2 million in 2010-11. Taking out the Special Disabilities Adjustment revenue, deficit spending would increase to \$47.2 million in 2009-10 and \$44.2 million in 2010-11. Deficit spending erodes balances and impairs a district's ability to maintain the required General Fund unrestricted reserve. Caution should be taken to assure that these expenditures are singular in nature and are not ongoing, multi-year commitments of the district. We encourage the district to make ongoing expenditure reductions to minimize deficit spending in future years.

Cash Flow

The state has adopted cash deferrals that will reduce the amount of cash available in certain months in 2010-11. The district issued Tax and Revenue Anticipation Notes (TRANS) of \$235 million in July 2010 to help address anticipated cash shortfalls. The cash flow submitted with the 2010-11 Adopted Budget projects the district will not have a negative cash balance in any month. However, the month of May will be very close. Therefore, the district is planning to borrow \$60 million from another fund to cover cash needs. Other options to help with cash flow include borrowing from other funds, spending freezes, working with vendors on the timing of revenues and payments, and borrowing from the County Treasury. We recommend that the district continue to closely monitor its cash situation.

Salary and Expenditure Increases

We note that the district has settled with its collective bargaining units for 2010-11. Before considering any new expenditure increases for 2010-11 or future years, the district should ensure that the costs will be supported by ongoing revenue to avoid creating or exacerbating structural deficits. The district should also take into account the proposed state budget reductions, projected deficit spending, and unrestricted reserve levels. We also recommend that the district protect its future financial integrity by assuring a minimum of reserves (including adequate reserves for contingencies) for at least the following two years of operation.

Fiscal Status in Future Years

Multi-Year Projection

Because of the ongoing state fiscal crisis, declining enrollment, and annual cost increases, the district projects that it will continue to face budget challenges in 2011-12 and 2012-13. The district's multi-year projection incorporates the following key assumptions: COLA on the revenue limit and categorical programs in 2011-12 and 2012-13, salary reductions will be restored in 2012-13 when the current collective bargaining agreement ends, K-3 Class Size reduction will be eliminated in 2012-13, and the Special Disabilities funding is included for 2009-10 through 2012-13. We have reviewed the district's assumptions for the multi-year projection and they appear to be reasonable. The MYP also shows that the district intends to make cuts of \$127.1 million in 2011-12 that have been identified and \$70.1 million in 2012-13 that have not yet been specified.

With these assumptions, the multi-year projection shows deficit spending in the Unrestricted General Fund of \$2.8 million in 2011-12. Taking out the district's placeholder for reductions in 2012-13, and reducing the revenue for the Revenue Limit COLA and Special Disabilities due to the uncertainty of these revenue streams, deficit spending would increase to \$23.9 million in 2011-12 and \$89.8 million in 2012-13. With this revised level of deficit spending, the district would have a negative ending balance of \$13.8 million in 2011-12 and \$67.2 million in 2012-13.

Based on this analysis, additional cuts of approximately \$36.4 million, beyond the \$127.1 million already identified will be needed in 2011-12 and \$89.8 million in 2012-13 to maintain a positive fund balance and meet the reserve requirement. The additional cuts needed in 2011-12 represent 6% of the district's Unrestricted General Fund expenditure budget.

Because the district is projecting to not have the required reserve on .67+% in 2010-11 and has a negative fund balance for 2011-12, the district's budget is conditionally approved. The district is required to readopt the budget making adjustments that will enable the district to meet its required reserve as well as adopt the resolution included in Attachment A by September 8, 2010. This resolution identifies the amount of the budget problem in 2011-12 and 2012-13 and requires the district to submit a detailed list of Board-approved budget reductions for 2011-12 and the district's timeline for implementation with the 2010-11 First Interim Report. As the district makes budget reductions, we recommend that the district identify ongoing cuts as opposed to one-time cuts to reduce the budget's structural imbalance.

Other Issues

Charter Schools

As the authorizing agency of 42 Charter Schools, the district maintains fiscal oversight responsibilities, particularly in the key areas of accounting, attendance accounting, budgeting, and payroll. Please see Education Code Section 47604.32 for a detailed list of oversight duties.

The district should review charter budget reports at each cycle: budget, first interim, second interim, and unaudited actuals. It is also the district's responsibility to transmit these reports to our office by the deadline. Please coordinate with your district's charter schools in advance to ensure that the deadline is met.

Should any circumstances arise related to the district's charter schools that would negatively impact the financial condition of the district, please notify this office as soon as possible.

Monthly Financial Reports

As a district utilizing an off-line financial system, you are required to provide our office with a monthly report by the middle of each month with the following information:

- General Ledger for each fund
- Budgeted and actual revenues by major object for each fund; and
- Budgeted and actual expenditures by major object for each fund.

Collective Bargaining and Other Disclosure Requirements

Our office requests that all districts submit a collective bargaining disclosure form to our office 10 working days prior to board action on a proposed settlement. Districts are also required to disclose salary settlements of \$0 and all proposed salary reductions. To be in compliance with AB 2756 (Daucher), both the Superintendent and Chief Business Officer must sign the collective bargaining disclosure form. The form is available in Excel format at <http://www.sdcoe.net/business2/dfs/?loc=formsdocs&m=1&pi=bas>. Districts must make any budget revisions within 45 days of approval of a collective bargaining agreement. Please send an expenditure report by major object that has been generated by your financial system showing the budget before the changes and a second expenditure report showing the budget after the changes.

Districts are also required to disclose non-voter approved debt and self-insured workers' compensation claims. This includes Bond Anticipation Notes, Certificates of Participation, Lease Revenue Bonds, etc. Copies of the required disclosure forms can be found on-line at: <http://www.sdcoe.net/business2/dfs/?loc=formsdocs&m=1&pi=bas>.

Implications of Conditional Approval

Pursuant to Education Code Section 42127(c)(2), the County Superintendent of Schools conditionally approves the district's budget at this time. The implications of a conditionally approved budget are discussed below.

1. Recommendations for Budget Revisions and Adjustments: As required by Education Code Section 42127 (d), our office recommends the district remove the revenue streams for the Special Disabilities funding for 2009-10 through 2012-13; project a zero COLA for 2011-12 and adjust the budget to meet the required reserve of .67+% for 2010-11.
2. School District Actions: On or before September 8, 2010, the governing board of the school district must: [Education Code Section 42127 (e)]
 - a. Revise the adopted budget to reflect the changes in projected revenue and expenditures subsequent to July 1, 2010
 - b. Include any responses to the recommendations of the County Superintendent
 - c. Hold a public hearing regarding the proposed revisions in accordance with Education Code Section 42103;
 - d. Adopt the revised budget. (As previously stated, the district can readopt the budget at the same time it approves the Unaudited Actuals and submit as one report if the district is able to meet the September 8 deadline);
 - e. Adopt the resolution shown in Attachment A which identifies the amount of cuts needed in 2011-12 and 2012-13 and requires the district to submit a detailed list of Board-approved budget reductions for 2011-12 and a timeline for making budget reductions with the 2010-11 First Interim
 - f. File the revised budget with the County Superintendent of Schools
3. Budget Authority: Until the district's budget is approved, the district must use the 2010-11 proposed budget as a working budget. [Education Code Section 42127.4]
4. Further County Office Review: Once the school district has submitted the required resolution, the county office will review the budget and determine whether it will be approved or disapproved by October 8, 2010.

Conclusion

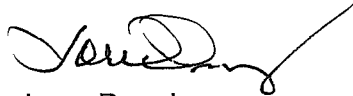
The ongoing nature of the state fiscal crisis has made budget reductions very difficult. It is imperative that the district follow through on budget reductions that have already been made and to continue to develop budget solutions in future years to ensure continued fiscal solvency of the school district.

We thank the Superintendent and staff of the San Diego Unified School District for providing us with detailed information about the district's budget and for cooperating closely with the San Diego County Office of Education. We appreciate the district's continued efforts to ensure fiscal solvency.

The district's adopted budget was developed prior to adoption of the 2010-11 State Budget. Actual state budget data should be reviewed and incorporated into the district operating budget and multi-year projection during the First Interim Report process.

Should you have any questions concerning this review, please feel free to call Linda Visnick at (858) 292-3537.

Sincerely,

A handwritten signature in black ink, appearing to read 'Lora Duzyk', with a long, sweeping flourish extending to the right.

Lora Duzyk
Assistant Superintendent
Business Services Division

LD: LV: SR

cc: Board President
Chief Financial Officer

